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In the Supreme Court of the United States

OCTOBER TERM, 1992

CHARLES L. HONEY,
PETITIONER
v.
UNITED STATES OF AMERICA,
RESPONDENT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Has the Eighth Circuit erroneously distinguished and refused to follow this Court's mandated guidelines for imposing the "100% penalty," as set out in *Slodov v. United States*, when the circuit court held the Petitioner was "willful," as a matter of law, and liable for this severe penalty, even though the trust fund taxes were dissipated by others before he gained effective financial control of the corporate employer and he had been found by the jury *not* to have willfully caused the corporation's failure to collect, account for and pay over these payroll taxes during the period of time when these delinquencies occurred?

2. Did the Eighth Circuit refuse to follow this Court's holding in *Slodov*, when it found the corporate employer's after acquired funds were "unencumbered" (for "100% penalty" purposes), after this circuit court itself specifically held that all of those after acquired funds were subject to a prior and superior security interest of other creditors and the corporation's daily payments to all creditors were made on a "forced paid" basis?

3. Did the Eighth Circuit err in reversing and rendering judgment against the Petitioner on the issues of fact presented on appeal, as opposed to remanding this case for a new trial (as timely requested by the Petitioner), when (1) the circuit court established definitive definitions for factual issues in the appeal in this case and then held that the Petitioner had failed to meet his burden of proof on these factual issues in the trial court; and (2) the government failed to strictly comply with the provisions of Rule 50 by making a timely motion for directed verdict against all parties and it never filed a motion for judgment *n.o.v.* against any party?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Charles L. Honey respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in the above-entitled proceedings on May 7, 1992.

OPINIONS

The Opinion of the United States Court of Appeals for the Eighth Circuit (App. A, *infra*, 1a) is reported at 963 F.2d 1083 (C.A.8, 1992). The Order of the Eighth Circuit Court of Appeals denying the petition for rehearing (App. C, *infra*, 33a) is unreported.

The Memorandum Opinion and Judgment (App. B, *infra*, 21a) of the Honorable Morris S. Arnold, District Judge, United States District Court for the Western District of Arkansas, entered on February 4, 1991, are reported at 760 F. Supp. 754 (W.D. Ark., 1991).

JURISDICTION

The judgment of the Eighth Circuit Court of Appeals (App. A, *infra*, 1a) was rendered on May 7, 1992, and a Petition for Rehearing was timely filed by the Petitioner and was denied on June 11, 1992 (App. C, *infra*, 33a). The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The pertinent provisions of the Internal Revenue Code (26 U.S.C. § § 3102, 3402, 6671, 6672, 7501 and 7512) are set forth in Appendix F, *infra*, 40a.

STATEMENT OF THE CASE

This case involves the correct determination of, and the legal principles applicable to, the assessment of the "responsible person" or "100% penalty" (26 U.S.C. § 6672). The controlling facts of this case are virtually indistinguishable from those found by the Court in *Slodov v. United States*, 436 U.S. 238 (1978), except that Charles L. Honey and James W. Meador were shareholders and/or officers of the corporate employer during the entire nine (9) month period of time the employment tax delinquencies accrued, though a jury specifically found they were knowledgeable and acted willfully with regard to these payroll tax delinquencies only during the last two (2) months of this period of time. The essential facts are as follows:

Corporation, Shareholders and Officers. Phoenix Housing Systems, Inc. (Phoenix), an Arkansas corporation, was created in November of 1984 as a part of a Chapter 11 Plan of

Reorganization for Precision–Bilt Homes, Inc. (Precision–Bilt), a company prefabricating modular housing units at a plant in Hope, Arkansas. Donald and Hilda Jackson (Jacksons), Precision–Bilt's sole shareholders, were then also in their own Chapter 7 bankruptcy proceeding. Charles L. Honey (Honey) was an attorney engaged in the private practice of law at Prescott, Arkansas (25 miles from Hope, Arkansas), and he was the bankruptcy counsel for Precision–Bilt. Precision–Bilt's Plan of Reorganization (approved by its creditors (including the IRS) and the bankruptcy court) called for the company to lease of all of its equipment to Phoenix with the rentals to be applied to pay Precision–Bilt's creditor's claims.

An investor was sought by the Jacksons to supply new capital to fund Phoenix. In late 1984, Donald Jackson interested F. Peter Lee (Lee) [1] into relocating to Hope, Arkansas, and he promised to contribute up to $250,000.00 of new funds to capitalize Phoenix. Honey agreed to join Lee in personally guaranteeing several bank loans made to Phoenix. Though no stock was ever actually issued, Lee was to be the majority shareholder, Charles White (the in–house accountant at both Precision–Bilt and Phoenix) and Honey were to have each held minority stock interests. Lee was elected President and Chairman of the Board of Directors, White a Vice–President, and Honey was the Secretary–Treasurer. These three also comprised the initial Board of Directors of Phoenix.

Donald Jackson was employed as the General Manager of Phoenix' manufacturing operations, and his wife was employed in the company's office. The Jackson's were treated as part of the management team of Phoenix and usually sat in on all of the

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[1] F. Peter Lee was alleged to have been a native of either Australia or New Zealand, a person of imposing presence and of supposed substantial net worth, who was then engaged in the real estate investment business in the Dallas/Fort Worth, Texas, area. Lee eventually contributed less than $30,000.00 of the funds he had promised to capitalize Phoenix.

Board's meetings. Shortly after operations began, James W. Meador (Meador), previously associated with a local savings and loan, was hired by Phoenix as a Vice-President to secure financing for Phoenix' customers' purchase of the company's prefabricated housing units. Meador was soon also declared a minority shareholder and a member of the company's Board.

Company's Operations. Phoenix purchased a large vacant manufacturing plant at the Hope Industrial Park from the Arkansas Industrial Development Commission (AIDC);[2] borrowed substantial operating capital from several banks; leased Precision-Bilt's equipment; and, in April of 1985, began manufacturing operations with about 30-40 employees. Lee, as president, was the person who was totally and solely in charge of all day-to-day operations of the company, including being the person who made all final decisions as to which creditors of the company would be paid and when. White kept the company's books and performed its accounting functions, including overseeing payroll and accounts payable. Meador sought financing for the company and for its customers' purchases from the company. Honey was not employed by Phoenix (except as the company's outside counsel), though he generally visited the plant when he was in Hope, usually on a weekly basis.

Lee, White, Meador and the Jacksons had employment contracts with Phoenix and were paid regular draws of anywhere from $500 to $1,000 per week. [3] Honey did not receive a salary or draw and, in fact, was never paid at all for the legal services he

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[2] Phoenix agreed to pay the AIDC only $925,000 for the plant, on an installment basis, though the structure was then appraised for more than $2.0 million. Lee and Honey also personally signed as guarantors of the company's promissory note to the AIDC.

[3] White testified that Lee specifically instructed him *not* to withhold any payroll taxes from these officer salaries, but to pay the gross amounts to these individuals, as "draws," though no promissory notes were ever signed by these individuals that would require repayment of these "draws" to the company.

rendered to Phoenix as the company's counsel. Company checks required two signatures. Honey initially signed company checks in blank in April and May and gave them to White, who, in turn, prepared checks to pay creditors and payroll and the checks were then countersigned by Lee. After Meador joined Phoenix, he was added to the checking account, and Honey thereafter signed few, if any, corporate checks.

Phoenix' Board meetings in April, May and June of 1985 consisted of once a month luncheons conducted by Lee at a local restaurant. Lee never gave the other Board members any concrete financial information about Phoenix' operations, but he continually painted a very rosy picture about the company's opportunities and potential. In June and July of 1985, Honey pressed Lee, in a series of letters, to provide him with a current financial statement for Phoenix and Honey threatened to resign if this financial information was not forthcoming. When Lee made no response on these inquiries, Honey resigned from Phoenix' Board by letter to Lee dated July 30, 1985. Honey also instructed Lee not to use his personal financial statement any further in connection with Phoenix' borrowings. At the August 1985 meeting of Phoenix' Board, the Board fired the Jacksons, for cause. The Jacksons then spent several weeks threatening Phoenix' management personnel.[4]

The uncontroverted testimony introduced at trial established that Phoenix would have been forced to have terminated its operations, at any time, if its day-to-day operating expenses, including payroll, had not been paid, because the production employees would have quit.

Company's Financing. During its entire existence, Phoenix never realized a profit from its manufacturing operations. Therefore, the company incurred substantial debt to fund its

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[4] Donald Jackson had previously been charged and tried for murder, and the members of the Board took his threats seriously.

operations. [5] The loans made to Phoenix by these separate lending institutions were secured by various UCC security agreements, written assignments, and mortgages covering all assets of the company. Merchants & Planters Bank held a security interest in the company's trucks, all inventory, all accounts receivable, an assignment in one specific contract, and the UCC Inventory Security Agreement that Phoenix signed with the Merchants & Planters Bank in August of 1985 (in return for the $90,390.41 loan) gave that bank a security interest in *all* of Phoenix' inventory, including a security interest in *all* of the proceeds realized from the inventory. [6] It is undisputed that Phoenix used the proceeds from all of these loans and all of its revenue from its manufacturing activities to finance its day-to-day operations.

Payroll and Payroll Tax Liabilities. From the start of operations, White informed Lee that the payroll taxes withheld from the wages of the company's employees should be deposited into a local bank, as required by law. However, Lee, as the controlling officer/shareholder, specifically directed White *not* to deposit such withheld payroll taxes, because Lee stated that the company could not afford to do so at that time. During its entire nine (9) month existence, Phoenix failed to timely pay over any of the payroll taxes required to be withheld from the wages or draws

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[5] Phoenix had: (1) two loans of $50,000.00 each ($100,000.00 total) from the Bank of Yellville at Yellville, Arkansas; (2) a letter of credit from the First National Bank of Hope, Arkansas, in the amount of $10,000.00; and (3) two loans from the Merchants & Planters Bank & Trust Company of Arkadelphia, Arkansas, in the respective amounts of $12,000.00 and $90,390.41. In addition, in December of 1985, Meador personally borrowed $20,000.00 from the Bank of Yellville, and, in turn, loaned these funds to the company where the funds were used to meet the company's production payroll during the month of December 1985.

[6] The exact wording of this Security Agreement (GX 50) provided:

(4) Borrower hereby grants to bank a security interest (constituting a first and paramount claim) in all of the borrower's inventory now owned or hereinafter acquired during the term of this Agreement, and in all proceeds of said inventory.

paid to its employees or officers.

White testified that he prepared the U.S. Quarterly Employment Tax Return (Form 941) for Phoenix for the second quarter of 1985 (before the July 31, 1985, due date) and presented the quarterly payroll tax return to Lee with a check (signed by Meador) that was drawn to pay the entire amount due. Though Lee signed the quarterly tax return, he refused to sign the check to pay the payroll taxes. White testified that he did not tell anyone else of these payroll tax delinquencies, until he told Meador in November or December of 1985, after Lee had disappeared.

Disappearance of Company's President. In late September or early October of 1985, Lee told the other shareholders of Phoenix that he had to go to the west coast to take care of a lawsuit and some personal business, but that he would return to Hope, Arkansas. For approximately a month, Lee stayed in daily telephone contact with Phoenix' office and with the company's bankers at the First National Bank of Hope. Lee continued to direct the company's operations, including responding to the IRS about Phoenix' nonpayment of the 8506 payroll taxes, and Lee specifically continued to direct payment of the company's creditors (until late in October, when he ceased calling and was never heard from again). In early November of 1985, when Meador determined that Lee was not going to return to Hope, he sought the counsel of Honey and White to try to determine what to do with Phoenix. It was determined by these shareholders to try and keep the doors open and find a buyer for the company, or the large manufacturing plant that the shareholders believed then had substantial value. These shareholders realized that a going concern would be more attractive to an investor than a closed plant, and that only through an infusion of new capital (whether from the sale of the building or a capital contribution by a new investor) could all creditors, including the IRS, be paid. Meador and White continued to run the company's day-to-day operations and Honey continued to act as outside counsel, though he met with Meador on a regular basis at Honey's law offices in Prescott after work. Meador stopped drawing a salary from Phoenix, operations were

cut back to work then in progress, and the majority of the company's production employees were terminated. After Lee physically left Hope in September of 1985, it became a daily occurrence that all of the Phoenix' checks presented for payment at the First National Bank of Hope had to be "force paid." [7] This process continued daily, until the company shut down entirely in late December 1985.

When all attempts to find a buyer for the manufacturing business or plant building failed, the Merchants & Planters Bank and the Bank of Yellville closed the business down (at the end of December 1985) by getting into a heated legal dispute over foreclosing on their respective collateral. First one of these banks, and then the other, had Phoenix' premises padlocked.

White took the payroll records of Phoenix with him when the company closed, and the accountant prepared, signed and filed U.S. Quarterly Employment Tax Returns (Forms 941) for Phoenix for the third and fourth quarters of 1985, sometime in January or February 1986.

100% Penalty Assessment. Sometime in 1987, the IRS conducted an investigation of the three unpaid payroll tax returns of Phoenix and separate 100% penalty assessments were made by

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[7] A witness from the First National Bank of Hope testified that Phoenix never (in its last several months of operation) had sufficient funds on deposit to cover the checks that were presented for payment each day in the ordinary course of the company's banking affairs. This bank officer testified that he called Meador every day and told him of the number of checks and the total dollar amount presented for payment on the company's account. Under banking regulations, the bank could not hold these checks for more than 24 hours, without returning them. Therefore, each day, Phoenix would deposit funds to cover as many of the company's outstanding checks as possible that had been presented for payment the previous day (though some checks were returned). There was never any excess amount deposited to allow Phoenix to have a surplus balance in its checking account at the First National Bank, after October 1985. This process of check payment was referred to as "force paid" by the company's banker.

the IRS against Lee, Meador and Honey on June 20, 1988, in the total amount of $112,375.49 (2nd Qt. $24,777.69; 3rd Qt. $62,805.39; 4th Qt. $24,792.41). No 100% penalty assessment was proposed by the IRS against White, the company's accountant, apparently because he could not sign corporate checks. These "100% penalty" assessments represented the "trust fund" portion of the income and FICA taxes withheld from the wages paid to Phoenix' employees during the three quarters of 1985.

Honey and Meador each made partial payments toward these assessments, and Honey filed claims for refund of his payments. When these claims for refund were denied by the IRS, Honey then sued for refund of the amounts paid and for abatement of the remainder of the assessment in the United States District Court for the Western District of Arkansas, Texarkana, Arkansas, pursuant to the provisions of 28 U.S.C. § 1346(a)(1). The United States then brought separate counterclaims against Honey, Meador and Lee for the unpaid balance of these assessments. Just before the case went to trial, in May of 1990, the United States dismissed its counterclaim against Lee, because the government could never locate Lee within the United States, so as to perfect service of its counterclaim upon him.

Judicial Considerations. Following a four day jury trial, the jury returned its verdicts in the form of answers to three special interrogatories (Appendix D, *infra*, 34a) to the general effect that:

> (1) Honey and Meador *were* responsible officers of Phoenix for the second, third and fourth quarters of 1985;
>
> (2) Honey and Meador were *not* "willful" for the failure of Phoenix to collect, account for and pay over the withheld payroll taxes for the second and third quarters of 1985, but that they *were* "willful" for such failure during the fourth quarter of 1985; and

(3) Honey and Meador became "willful" for the failure of Phoenix to collect, account for and pay over the withheld payroll taxes during the fourth quarter of 1985 on October 31, 1985.

Based upon the jury's verdict, the parties agreed to submit to District Judge Morris S. Arnold the factual question of the amount, if any, of unencumbered funds that came into the possession of Phoenix after October 31, 1985. Judge Arnold's detailed Memorandum Opinion (760 F. Supp. 754, Appendix B, *infra*, 21a) determined that Phoenix had no unencumbered funds in its possession, after October 31, 1985, from which the prior payroll tax liabilities could have been paid. Judge Arnold then entered judgment against Honey and Meador (App. C, *infra*, 33a) on the government's counterclaims, in the amount of $12,011.10, i.e. the balance (less payments) of the "trust fund" portion ($13,161.10) of the payroll taxes that should have been withheld from the wages paid to Phoenix' employees during the months of November and December 1985.

The United States appealed from this judgment to the Eighth Circuit alleging that Judge Arnold had erroneously determined that there were no unencumbered funds in Phoenix' bank account during November and December of 1985, when $114,179.23, in total, was run through the company's bank account at the First National Bank of Hope to pay company creditors, including payroll. Honey and Meador defended the appeal on this question of unencumbered funds. Honey also raised the question on appeal (in defense of the judgment) that he should not be held liable, as a matter of law, for *any* "100% penalty" liability that accrued before October 31, 1985, because the jury found that he had *not* "willfully" failed to withhold, account for and pay over the company's payroll taxes prior to that date. Since all such withheld payroll taxes had been dissipated by Lee (because there were no funds at all in Phoenix's bank account) prior to October 31, 1985, then, based upon the guideline rulings set down in this Court's *Slodov* decision, there were absolutely no after acquired funds in the company's bank account that were subject to a "trust fund"

status, and he had no duty to pay over these prior payroll tax delinquencies from the after acquired funds deposited by Phoenix to its bank account in November and December of 1985.[8]

The Eighth Circuit reversed the district court's decision, and found, as a matter of law, that Honey and Meador had acted "willfully" (within the meaning of 26 U.S.C. § 6672) when expenditures of $114,179.23 were made by Meador from Phoenix' corporate bank account to pay operational expenses and payroll during November and December of 1985. The circuit court made this decision (even though there were no traceable "trust funds" from prior withheld income and FICA taxes in the company's bank account on October 31, 1985) because that court found these shareholders had an absolute *duty* to pay over the dissipated payroll taxes attributable to the period before October 31, 1985, from all of the company's after acquired funds (963 F.2d 1087). The Eighth Circuit distinguished this Court's mandated requirement (in *Slodov*) that a responsible person must be found to have acted "willfully" (before the "100% penalty" liability attaches), by holding that, since Honey and Meador were found by the jury to have been "responsible persons" for all three taxable quarters (not just for the period after October 31, 1985), they had a *duty* to pay over the prior payroll tax delinquencies from all of the company's after acquired funds (once they became aware of the existence of these tax delinquencies) and that they acted *willfully* by Meador's paying of other creditors after that date.

Further, even though the Eighth Circuit specifically found that Phoenix' creditor banks had prior and superior security interests (as compared to the IRS) in the after acquired funds held

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[8] Though Honey did not file a formal Notice of Cross Appeal on this issue, he defended the appeal on this ground, as he had defended against the assessment on this issue in the trial court, because the same judgment would result under either theory of defense. Therefore, he maintained that the circuit court had the power to affirm the trial court on this alternative theory. See, *Lane v. Peterson*, 899 F.2d 737 (C.A.8, 1989), *cert. denied*, 111 S. Ct. 74 (1990).

in the company's bank account at the First National Bank of Hope (and that any attempt to levy on this account by the IRS, after the filing of a federal tax lien, would have been defeated by the banks' superior security interests in such funds), and even though the funds placed in this bank account were "force paid" every day after October 31, 1985, the circuit court found that these funds were "unencumbered" (for purposes of § 6672) because the secured lenders had not directed how the payment of these funds should be made by Phoenix. Therefore, all of these "unencumbered" funds that passed through the company's bank account after October 31, 1985, were counted for purposes of measuring the "100% penalty" that had been assessed against Honey and Meador.

The Eighth Circuit also found that it had the power to reverse and render judgment for the United States in this case, even though the United States had procedurally failed to make a timely motion for directed verdict against Meador at the close of all the evidence, the government had failed to file motions *j.n.o.v.*, and the Petitioner had timely requested the circuit court to remand for a new trial.

REASONS FOR GRANTING THE WRIT

Existing Conflicts. The decision by the circuit court in this *Honey* case appears to conflict directly with this Court's adoption of specific bright line rules for administering the "100% penalty," as set forth in the case of *Slodov v. United States*, 436 U.S. 238 (1978). This circuit court, in the face of *Slodov* decision, erroneously held that Honey should be treated differently than Slodov was (in an almost identical factual circumstance), because the jury had found Honey had been a "responsible person" during the entire nine (9) month period that the corporation's payroll tax delinquencies accrued, though this same jury had specifically found that Honey had *not* acted "willful" to cause the delinquencies, until the last two (2) months of that period. Because the withheld payroll taxes had been dissipated by another responsible person, and there were no funds in the company's bank account on the date Meador and Honey were found to have gained effective financial

control of the business, by default (after Lee disappeared), Honey submits that the Eighth Circuit erred in imposing an absolute *duty* upon him to pay over to the IRS the delinquent withholding tax liabilities from the corporation's after acquired funds that were deposited into the corporate checking account during November and December 1985. The circuit court erred in finding Honey *willful*, as a matter of law, for breaching such *duty* by allowing other corporate creditors to be paid by Meador.

The Petitioner also submits that the decision by the Eighth Circuit in this case is also in direct conflict with other decisions of the Eighth Circuit, itself, regarding the proper application of these *Slodov* standards. Though the panel of judges that decided this case distinguished other "100% penalty" decisions of the Eighth Circuit that properly interpreted the *Slodov* principles, and the members of the circuit court denied the Petitioner's suggestion for rehearing *en banc*, the Petitioner submits that there exists a clear conflict between the Eighth Circuit's decisions on this point of law.[9] Likewise, the Petitioner submits that there is a clear conflict between the decision by the Eighth Circuit in this case and the well reasoned decisions of a district court in the Tenth Circuit [10] (which circuit has not addressed this question), and a bankruptcy court in the Eleventh Circuit (which circuit also has not addressed

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[9] The Petitioner submits that the Eighth Circuit's prior decisions in the case of *Elmore v. United States*, 843 F.2d 1128 (C.A.8, 1988) and *Kenagy v. United States*, 942 F.2d 459 (C.A.8, 1991), properly apply the principles and guidelines announced by this Court in its *Slodov* decision and that these principles should have been applied to uphold the decisions of the jury and the district court in this case. Conversely, the Petitioner submits that the prior decisions of the Eighth Circuit in *Kizzier v. United States*, 598 F.2d 1128 (C.A.8, 1979) and *Olsen v. United States*, 952 F.2d 236 (C.A.8, 1991), which were cited by the panel of circuit judges who decided this case as correctly applying the guiding principles announced in this Court's *Slodov* decision, are erroneous decisions that cannot be rationally distinguished from the *Elmore* and *Kenagy* decisions rendered by this same circuit court.

[10] *Johnson v. Internal Revenue Service*, 663 F. Supp. 294 (D.C. Utah, 1987).

this question), [11] which decisions correctly applied the *Slodov* mandated standards in factually similar cases. The Petitioner submits that this case presents a very important and commonly reoccurring question in the administration of the internal revenue laws upon which there is conflict among the inferior federal courts as to how this Court's controlling bright line rules for administering the "100% penalty," as announced in the *Slodov* case, should be applied. [12] The Court should grant the Petition to further clarify its guidelines for imposing the "100% penalty," where there has been a change in the effective financial control of a corporate employer because of a change in its management.

Unencumbered Funds. Important questions of federal tax law are also presented by this case with regard to the questions of: (1) what duty exists to pay over delinquent payroll taxes from after acquired funds (when the withheld taxes were dissipated before the corporate officer acquired effective financial control of the corporate employer), and (2) what test should be applied to determine

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[11] *In Re Matter of King*, 91-2 U.S.T.C. ¶ 50,330 (B.C.N.D., Ala., 1991).

[12] Petitioner acknowledges that the Circuit Courts of Appeal for the Fifth Circuit, *Mazo v. United States*, 591 F.2d 1151, 1157 (C.A.5, 1979), *cert. denied*, 444 U.S. 842 (1979); the Seventh Circuit, *Garsky v. United States*, 600 F.2d 86, 91 (C.A.7, 1979); the Third Circuit, *United States v. Vespe*, 868 F.2d 1328, 1334-35, (C.A.3, 1989); the Eighth Circuit in *Kizzier v. United States*, 598 F.2d 1128, 1134 (C.A.8, 1979) (and the instant case); and the Ninth Circuit, *Davis v. United States*, 963 F.2d 867, 871-878 (C.A.9, 1992), have all rendered decisions that erroneously try to distinguish this Court's mandated requirement that a person must be found to have acted "willfully," before the 100% penalty liability applies, in instances where the person against whom the assessment has been made was factually determined to have been a "responsible person" during the period that the payroll tax delinquencies occurred. However, the Petitioner notes to the members of this Court that a Petition for Certiorari will be filed by the corporate officer in the *Davis* case from the Ninth Circuit, and that Petitions for Certiorari were *not* filed in the *Garsky* case from the Seventh Circuit or the *Vespe* case from the Third Circuit. The Petition for Certiorari denied by this Court in the *Mazo* case was handed down in 1979 (only one year after this Court rendered its decision in *Slodov*), before the current conflict on this point became apparent.

if the after acquired funds of a corporation are "encumbered" or "unencumbered," for purposes of measuring the liability for the "100% penalty" provided by 26 U.S.C. § 6672. This Court has never rendered a decision giving direct guidance to the inferior federal courts as to what *duty*, if any, exists on a corporate officer to pay over in these factual circumstances and what constitutes "encumbered" and "unencumbered funds," for purposes of this "100% penalty." Though this Court briefly mentioned the "encumbered" funds issue in its *Slodov* opinion, the Petitioner submits that this case provides the Court with an appropriate vehicle to provide definitive answers to all of these important questions.

Limited Remedy Available. Finally, the Eighth Circuit clearly ignored the limitations placed upon it by Rule 50 of the FRCP, concerning the limited remedy available to the government in its appeal, i.e. a remand for a new jury trial, *not* the rendering of a judgment *n.o.v.* against the Petitioner. The government's counsel failed to make a timely motion for directed verdict at the close of all of the evidence against all counter–defendants, and the government failed to timely file motions *j.n.o.v.*, against any party. On appeal, the Petitioner timely requested that the case be remanded for new trial, if the jury verdict and decision of the district court were overturned. Though this appellate court established definitions of critical factual terms regarding the "100% penalty" in its decision (on appeal in this case) and that court found that Petitioner had failed to meet his burden of proof in the trial court (under these new definitions), it refused Petitioner's timely request for remand for a new trial to give the Petitioner an opportunity to meet his burden. The decision here clearly conflicts with the express wording of Rule 50(d) of the FRCP and the prior decision of this Court in *Neely v. Martin K. Eby Construction Co.*, 386 U.S. 571 (1967). This Petition for Certiorari should be granted to allow the Court to protect the integrity of its controlling decision and to provide guidance to the inferior federal courts in their interpretation of the provisions of Rule 50 of the FRCP in this type of factual setting, where there is an appeal (on factual findings) from a combination of a jury verdict and district court decision.

I. FIVE CIRCUIT COURTS HAVE ERRONEOUSLY DISTINGUISHED AND LIMITED THE EFFECT OF THIS COURT'S GUIDELINE RULINGS IN *SLODOV V. UNITED STATES*, SO THAT THE RATIONALE OF THE STRICT LIABILITY ARGUMENT MADE BY THE GOVERNMENT (AND REJECTED BY THIS COURT IN *SLODOV*) HAS NOW BEEN ACCEPTED BY THESE CIRCUIT COURTS, SO AS TO EFFECTIVELY PENALIZE RESPONSIBLE PERSONS WHO DID NOT WILLFULLY CAUSE THE PAYROLL TAX DELINQUENCIES TO OCCUR.

a. No Strict Liability. In *Slodov v. United States*, *supra*, this Court specifically rejected the government's argument for strict liability for the "100% penalty," as a matter of law, for any responsible persons (based upon this status), when there has been a change in the effective financial control of the corporation and the delinquent payroll taxes are not paid by these responsible persons from the corporation's after acquired funds. Instead, the Court adopted a series of bright line rules as guidelines for the federal courts to use in determining the proper imposition of the "100% penalty," when there has been a change in the effective financial control of a corporate employer's management, *either* through a change in ownership *or* (as here) a change in management.

Based upon policy considerations, this Court held in *Slodov* that: (1) the liability for this severe penalty cannot arise without *knowledgeable* action on the part of the responsible person; (2) where the delinquent taxes have been dissipated by the prior controlling responsible person, *only* the unencumbered funds or liquid assets of the company on hand (on the date the responsible person assumes effective financial control) are impressed with a "trust fund" status; (3) the after acquired funds of the corporate employer are *not* impressed with a "trust fund" status (unless these funds can be traced to the prior withheld taxes); (4) there is no *duty* to use the after acquired funds to pay prior payroll tax deficiencies (after the responsible person acquires effective financial control); and (5)

the IRS should not be able to better its position by imposing the "100% penalty" on the responsible persons, when the IRS's claims to the corporation's after acquired cash is inferior to that of other secured creditors of the business.

b. Conflicting Decisions. This Court succinctly stated in *Slodov* (436 U.S. at 254) that --

> Section 6672 cannot be read as imposing upon the responsible person an absolute duty to "pay over" amounts which should have been collected and withheld. The fact that the provision imposes a "penalty" and is violated only by a "willful failure" is itself strong evidence that it was not intended to impose liability without personal fault.

However, the Eighth Circuit and four other circuit courts (see footnote 12, *supra*) have now distinguished this Court's bright line tests announced in *Slodov*, so as to effectively limit the applicability of that decision to the facts presented, i.e. only where there is a change in effective financial control of the corporate employer due to a change in stock ownership in the company.

These five appellate courts have adopted a legal position that holds this Court's *Slodov* rulings inapplicable where the responsible persons held that status when the payroll tax delinquencies accrued, even though such responsible persons were *not* in control of the corporation and did *not* willfully cause these payroll tax delinquencies to occur. These courts have each ruled that, when these responsible persons subsequently become aware of, or knowledgeable about, the prior payroll tax delinquencies, they then have an absolute *duty* to use all after acquired corporate funds that are unencumbered to pay toward those prior delinquencies. If the responsible persons fail to make such payments (but, instead, use such funds to pay other corporate creditors), such failure to "pay over" is deemed, as a matter of law, to meet the "willfulness" requirement of § 6672. The Petitioner submits that,

as a matter of law, this is an erroneous interpretation of § 6672 that flies in the face of this Court's *Slodov* rulings, especially where, as here, there has been a change in *corporate management*, i.e. the person or persons who have effective financial control of the corporation.

The Petitioner submits that the correct interpretation of §6672 and the correct implementation of this Court's *Slodov* rulings (in a factual situation such as is presented in this case) have been made by federal district and bankruptcy courts in circuits where the appellate courts have not addressed this precise issue. In *Johnson v. Commissioner*, 663 F. Supp. 294 (D.C. Utah, 1987) (a decision not appealed by the IRS), the district court held that the rationale adopted by the Fifth, Seventh and Eighth Circuits to distinguish this Court's standards mandated in *Slodov* was erroneous. After reviewing this Court's bright line rules set down in *Slodov*, the district judge held that the responsible person's failure to pay over the delinquent payroll taxes to the IRS from the corporation's after acquired funds did *not* constitute willfulness for purposes of §6672. That lower court did hold that (663 F. Supp. 298–299) --

> Upon analysis it becomes clear that plaintiffs in this case are in no different position than was the taxpayer in *Slodov*. Here, as in *Slodov*, the taxpayer was innocent with regard to the original failure to collect, account for, and pay over payroll taxes. Here, as in *Slodov*, the taxpayer if well counseled would recognize that once he or she has knowledge of the dissipated withholdings there can be no penalty if the choice is made to discontinue operations. Here, as in *Slodov*, there is no nexus between the dissipated withholdings and the after-acquired cash. Finally, here, as in *Slodov*, there is no showing of personal fault.
>
> Based upon the foregoing analysis the court holds that penalties cannot be imposed upon plaintiffs based upon their payment of corporate

> creditors with cash acquired after they learned of the failures to pay tax withholdings, so long as the responsible person did not play a "willful" role in that failure.

See also, the decision of the Bankruptcy Court for the Northern District of Alabama that independently came to exactly the same conclusion in *In the Matter of King*, 91-2 U.S.T.C. ¶ 50,330 (B.C.N.D. Ala., 1991). This *King* decision is now on the government's appeal to the District Court for the Northern District of Alabama.

c. Control is the Applicable Test. The key factor in the proper implementation of this Court's *Slodov* standards (for the "100% penalty" in this type of factual situation) is to ascertain if there has been a change in the effective financial control of the corporate employer, *either* by a change in ownership *or* (as here) by a change in management. Petitioner notes that this Court's majority opinion in *Slodov* used the term "control" seventeen (17) times, and the Court refused to base its opinion upon the mere *responsible person* status of the corporate officer. [13]

Here, Honey was not active in the day-to-day operations of Phoenix; he had resigned from the Board and acted only as the company's outside counsel; though he remained as a shareholder

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[13] It is important for the members of this Court to note that, in footnote 7 of its *Slodov* opinion (436 U.S. at 246), Justice Brennan specifically stated that the Court would use the *short hand phrase* "responsible person" without adopting any of the constructions placed upon the term by the various circuit court decisions where it was used. This reservation by the Court, in not further defining the term "responsible person," is another reason why the Court should grant Honey's petition in this case, to take the opportunity to further delineate a responsible person's duties, and to overturn and reject the rationale of the subsequent decisions of the circuit courts (see footnote 12, *supra*) that have erroneously imposed the "100% penalty" upon responsible persons merely because of their status, not because of any willful or knowing breach of any duty imposed upon them by that status when the payroll tax delinquencies occurred.

and as a guarantor of certain large corporate debts. Honey attempted to assist Meador and White in their attempts to raise the company from its financial ashes (like its namesake) by trying to find either a new capital investor or a purchaser of the company's assets. The fact that Honey was found by the jury to have been a responsible person throughout the nine (9) month period of time Phoenix conducted operations does not place any *duty* or responsibility upon him that is different from the duties or responsibilities placed upon Dr. Slodov when he acquired control of his three companies on January 31, 1969. In both instances, the responsible persons discovered that the corporation had no available funds (the withheld payroll taxes having been previously dissipated by others in control) when they acquired effective financial control of the corporation, and none of these persons had done anything knowingly to willfully cause the prior payroll tax delinquencies to occur.

From the jury's findings in this case, Honey and Meador are clearly deemed to have acquired effective financial control of the corporation only upon the disappearance of the company's president (Lee); the sole person who had complete financial control of the company up until October 31, 1985. Thus, Petitioner submits that his mere status as a responsible person, when he and Meador acquired effective financial control of Phoenix, should in no way affect his ability to claim the limitations upon, or safe harbors from, the "100% penalty," as provided by this Court's bright line rules set down in *Slodov*.

d. Practical Application of Bright Line Rules. In the factual situation where the withheld payroll taxes have been dissipated by others and there are no unencumbered funds or funds traceable to these withholdings on the date the responsible person becomes knowledgeable of these facts, this Court held, in *Slodov*, that there was no "100% penalty" liability for the use of after acquired funds by a responsible person who purchased his control of the corporate employer after the payroll tax delinquencies accrued, principally because there was no *nexus* between these funds and the delinquent payroll taxes. This Court therefore reasoned that 26 U.S.C. § 7501 did not impose a "trust fund" status

upon such after acquired funds. Likewise, in *Elmore v. United States*, 843 F.2d 1128 (C.A.8, 1988), the Eighth Circuit itself recognized (in interpreting and applying *Slodov*) that there was no "100% penalty" liability for the use of after acquired funds by a responsible person who had been a 50% shareholder, an active officer and a Board member, but who acceded to effective financial control of the company, only by default, when his partner (the other 50% shareholder, who had had financial control of the corporation) unexpectedly died. In *Elmore*, the jury found that the surviving shareholder was neither a responsible person nor had he acted willfully in causing the payroll tax delinquencies during the period of time they accrued.

Though the facts in this *Honey* case are admittedly one step closer than those in *Elmore* to the traditional "100% penalty" scenario (i.e. "when the same individual who *caused* the delinquency in any tax quarter [is] also the 'responsible person' at the time the government's efforts to collect from the employer have failed, and it seeks recourse against the 'responsible employees'" (436 U.S. 245–246)), the Petitioner submits that, as a matter of law, he has no personal liability for the "100% penalty" assessed in this dispute for periods up to October 31, 1985, because he also qualifies for the "safe harbor" from the "100% penalty" that is provided by this Court's *Slodov* guidelines. Honey did not act "willfully" to cause these payroll delinquencies of Phoenix prior to October 31, 1985, and there were no traceable funds with a *nexus* to the delinquent payroll taxes that were on hand when he was determined to have gained effective financial control of Phoenix, by default. There is no rational or logical reason for the courts to uphold the "100% penalty" assessment made against Honey by the IRS for periods prior to October 31, 1985, when both Slodov and Elmore were found not to have such liability in the same factual circumstances. If the Petitioner had resigned from Phoenix on October 31, 1985, and left the company totally in Meador's hands, it is agreed that Honey would *not* have been liable for *any* § 6672 penalty, because he had no personal fault for the company's failure to withhold or pay over these payroll taxes prior to that date.

This Court should grant Honey's Petition and take the opportunity in this case to further clarify its bright line rules announced in *Slodov*, so as to let both the IRS and the nation's business community know that a person with "current" responsible officer status cannot be held liable for the "100% penalty" merely because of that status alone, when such person steps forward to acquire effective financial control of the corporate employer to try and save the business, where that person had no personal fault in the company's prior failure to collect, account for and pay over its payroll taxes.

e. Policy Considerations. Petitioner Honey submits that there is absolutely no difference in the policy consideration decisions made by this Court in freeing the responsible person from the "100% penalty" in *Slodov*, and those applicable to him and Meador in the instant case. Though the jury found that both Honey and Meador were responsible persons throughout the nine (9) month period of Phoenix' existence, the jury specifically found that they did *not* willfully cause the corporation to fail to collect, account for and pay over the employment taxes for periods prior to October 31, 1985. Clearly, by its verdicts, the jury found that Lee was the sole controlling responsible person who willfully acted in causing Phoenix to fail to collect, account for and pay over the withheld employment taxes for the first seven (7) months of the company's operations.

Upon assuming effective management control of Phoenix, by default, Meador immediately pared the employee rolls to only those workers needed to complete the work then in progress; he quit taking a salary; and he personally borrowed $20,000.00 that he contributed to the company to fund payroll. Honey still had no active role in the management of the company after October 31, 1985, and Honey only visited and consulted with Meador at his law office in Prescott, Arkansas (where Meador also lived), usually in the evenings after the business had closed, in an attempt to salvage the business and to pay the creditors, including the IRS. Though Meador and Honey's attempt to refinance or sell the company failed, they have recognized their personal liability for the

corporation's failure to pay over its payroll taxes during the last two (2) months of its existence, after Lee's disappearance. These individuals have now satisfied the $13,161.00 judgment jointly entered against them for the "trust fund" portion of the payroll taxes that accrued in November and December of 1985. However, the Petitioner submits that neither he nor Meador, as responsible persons, should be "hammered" with the heavy civil penalty ($100,000.00, plus accrued interest) that has effectively been imposed upon them, as a matter of law, by the Eighth Circuit's erroneous interpretation of this Court's *Slodov* standards, simply because they tried to salvage the business for the benefit of all concerned. This is especially true where this heavy civil penalty cannot be discharged even by a Chapter 7 bankruptcy filing (*United States v. Sotelo*, 436 U.S. 26 (1978)).

The Petitioner submits that the Eighth Circuit's decision here to hold him strictly liable for the "100% penalty" (because he did not try to stop Meador from expending corporate funds during the two months that they tried to salvage Phoenix' business) is a situation where the circuit court paid insufficient heed to the conflicting policy considerations this Court contemplated in *Slodov:* to wit "the need for the collection of taxes vs. the need to rehabilitate financially troubled corporations." If inactive shareholders, like Honey, are to be held strictly liable for this heavy civil penalty in these factual circumstances, then well advised corporate officers and shareholders will, indeed, be sure to resign immediately upon learning of the corporation's payroll tax delinquencies. The decision by the Eighth Circuit in this case encourages individuals like the Petitioner to leave the IRS to its certain bankruptcy claim, rather than to remain and attempt to rehabilitate the business for the benefit of *all* creditors, including the IRS.

The circuit court below, in accepting the government's strict liability argument, effectively holds Honey liable for a payroll tax delinquency actually caused by others without his knowledge, if he personally undertakes (or knowingly allows others to undertake) to try to rehabilitate the corporation. If this decision is allowed to stand, it will surely militate against any such

rehabilitative action by a knowledgeable and well counseled corporate shareholder or officer. The policy issue raised here, as in *Slodov*, is whether the law should exult tax collection over encouraging rehabilitative attempts for financially troubled corporations. Honey submits that the goal of rehabilitation was found by this Court in *Slodov* to have the dual benefit of satisfying both of these policies, since the IRS's ultimate possibility of collecting the delinquent taxes will be enhanced by encouraging the business' rehabilitation through a new infusion of capital. Honey therefore submits that there are no "policy reasons" why he should be penalized and treated differently for his efforts to try and help rehabilitate Phoenix Housing than was Dr. Slodov for his attempts to try and rehabilitate his three financially troubled food service companies.

For these reasons alone, the Petitioner submits that the Court should grant his Petition, reverse the Eighth Circuit's erroneous and ill conceived limitation upon the bright line rules set forth by this Court in its *Slodov* decision, and provide guidance to both the IRS and the nation's business taxpayers on these important questions of the proper administration of the federal tax laws where similarly situated citizens are now being treated differently.

II. EVEN IF HONEY HAD A DUTY TO PAY OVER THE PRIOR PAYROLL TAX DELINQUENCIES FROM THE CORPORATION'S AFTER ACQUIRED FUNDS, ONCE HE BECAME AWARE OF THE EXISTENCE OF SUCH DELINQUENCIES, THE CIRCUIT COURT ERRED IN FINDING THAT ALL SUCH AFTER ACQUIRED CORPORATE FUNDS WERE UNENCUMBERED, FOR PURPOSES OF THE "100% PENALTY."

The IRS has historically attempted to measure the "100% penalty" liability of a responsible person by merely totalling up the moneys deposited to (and expended from) the corporation's bank account, after the responsible person becomes aware of the

corporation's payroll tax delinquency. [14] The Petitioner submits that the government's test for the measure of the "100% penalty" is illusory, as noted by the district court (760 F. Supp. at 758) "because the government's test perhaps has about it a deceptive aura of rectitude and equity, and might therefore seem to be the one that the court should adopt, the court will devote some discussion to demonstrate the unreliability of its proposed method." The district court then made a detailed and logical analysis to show how the mere deposit and expenditures of such moneys did not, in their totality, represent "unencumbered funds" available to pay the IRS's claim for the prior payroll tax delinquencies. [15]

On appeal, the Eighth Circuit acknowledged (963 F.2d 1090) that there was a dearth of case law interpreting what were "encumbered" and "unencumbered" funds (for purposes of this "100% penalty"). However, the circuit court rejected the district court's analysis, and found that *all* of the funds deposited into and expended from Phoenix' bank account during the months of November and December of 1985 were "unencumbered," for purposes of the § 6672 penalty. The very narrow definition of "encumbered" funds adopted by the Eighth Circuit in this case (963 F.2d 1089–90) was lifted (in its entirety) from a bankruptcy court's definition in the case of *In re Premo*, 116 B.R. 515 (B.C.E.D.

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[14] In the instant case, without deduction for Meador's $20,000 personal loan, or taking into consideration the "multiple counting" that is attributable to the normal turn of a corporation's working capital during its business cycle, the evidentiary record establishes that $114,179.23 was run through Phoenix' bank account in November and December of 1985, and the "100% penalty" assessed for all three taxable quarters was $112,375.49. Of this latter amount, $13,161.10 was attributable to payrolls for November and December 1985 and $99,214.39 was attributable to payrolls for the first seven (7) months of Phoenix' operations.

[15] The unreliability of the bank deposits and expenditures method of measuring the "100% penalty" liability is pointed up by the undisputed fact that, as a practical matter, if Phoenix had not continued to "force pay" its payroll or its suppliers in November and December of 1985, the company would have had to close, and there would not have been $114,179.23 run through the company's bank account for the IRS to use as a measuring standard.

Mich., 1990). In essence, the appellate court has held that a business' funds are "unencumbered," unless a creditor with a prior and superior security interest in the funds directs the responsible person to use the funds for purposes that would in some way prohibit the payment of the delinquent payroll taxes.

The Petitioner submits that this definition of "encumbered" funds is too restrictive and is in direct conflict with the rationale of this Court's ruling in *Slodov* (436 U.S. at 259). There this Court recognized that if the IRS's tax lien was inferior to a properly perfected security interest that had previously been filed of record, the expenditure of such after acquired funds could *not* be used as the measure of a responsible person's liability for the "100% penalty." This Court stated there --

> Thus, although the IRS is powerless to attach assets in which a secured party has a superior interest, it would impose a penalty under § 6672 if the responsible person fails to divert the secured party's proceeds to the Treasury without regard to whether the secured party's interests are superior to those of the government. Surely, Congress did not intend § 6672 to hammer a responsible person with a threat of heavy civil and criminal penalties to pay over proceeds in which the Code does not assert a priority interest.

In spite of this direct admonition by this Court and the Eighth Circuit's own specific finding (963 F.2d at 1092) that the security interest of the Merchant & Planters Bank in all of Phoenix' accounts receivable and cash would have been superior to any tax lien supported claim made by the IRS (if the IRS had even filed a tax lien), the appellate court held that such after acquired funds were, as a matter of law, "unencumbered" and their expenditure was a proper measure for the Petitioner's "100% penalty" liability. Therefore, this lower court has, in effect, held that these after acquired funds have a "trust fund" status (though they have absolutely no *nexus* with the delinquent payroll taxes) and, if the

IRS "lays behind the log" and lets the responsible person expend these after acquired funds (in which another creditor has a prior and superior security interest in trying to rehabilitate the company, the taxing agency will be allowed to benefit greatly by increasing its "take" under the § 6672 penalty, when it could never have reached these after acquired funds of the company by direct levy.

This Court should grant the Petition in this case to clarify its prior comments on this subject, and also take the opportunity to render a definitive decision on this important question as to what is meant by "encumbered" and "unencumbered" funds for purposes of imposing the "100% penalty."

III. THE CIRCUIT COURT VIOLATED THE PROVISIONS OF RULE 50(d) OF THE FEDERAL RULES OF CIVIL PROCEDURE BY REVERSING AND RENDERING JUDGMENT FOR THE UNITED STATES, RATHER THAN REMANDING FOR A NEW TRIAL, UNDER THE FACTUAL CIRCUMSTANCES OF THIS CASE AND AS TIMELY REQUESTED BY THE PETITIONER.

In the trial court, all parties made oral motions for directed verdict at the close of the Plaintiff's case, and all such motions were denied. At the close of the all the evidence (when all parties had rested), counsel for the government moved for a directed verdict against Honey, but totally failed to renew the government's motion for directed verdict against Meador. Government counsel did not timely file a motion for judgment *n.o.v.* against Meador or Honey, pursuant to the provisions of Rule 50(b) of the FRCP. The district court's ultimate findings of fact, regarding the status of "unencumbered" funds, was a factual determination that was inextricably based upon the underlying factual findings of the jury concerning the date upon which both Honey and Meador were found to have begun to act "willfully" (in effect, the date they acquired effective financial control of Phoenix). These jury determinations were, in turn, made based upon the district court's

jury instructions (Appendix E, p. 37, *infra*). The definitions of willfulness and responsibility in these jury instructions were substantially changed by the Eighth Circuit's opinion in this very appeal.

On appeal, the Eighth Circuit ruled, as a matter of law, that Honey and Meador willfully failed to pay over the withheld taxes from funds acquired by the corporate employer after the Petitioner was found by the jury to have known about the company's pre-existing payroll tax delinquencies. Also, the Eighth Circuit adopted, for the first time, a *new* definition of the terms "unencumbered funds," for purposes of the "100% penalty."

Exercising his rights under Rule 50(d) of the FRCP, Petitioner Honey filed a formal request for a new trial with the Eighth Circuit, prior to the oral argument and prior to submission of this case to the circuit court for decision. However, in its decision, the circuit court erroneously held that, because there was an appeal from *both* the jury's verdict and the district court's decision, that the provisions of Rule 50 (regarding motions for directed verdict and motions *j.n.o.v.*) were not applicable. The Eighth Circuit denied the Petitioner's Motion for Rehearing that specifically raised this procedural question as to the limitation on the circuit court's power to reverse and render, rather than ordering a new trial, as the proper remedy in this case.

The Petitioner submits that the Eighth Circuit's reversing and rendering of judgment in favor of the government, when government counsel failed to preserve the government's procedural rights by making the required motion for directed verdict against all parties at the close of the evidence and by failing to file a timely motion *j.n.o.v.* is a clearly erroneous and improper action. The Petitioner submits that the circuit court is limited to reversing and remanding this case for a new trial, especially in light of the Petitioner's timely request for such a remedy.

As Justice White noted in his opinion in *Neely v. Martin Keeby Construction Co.*, 386 U.S. 317 (1967), "an appellate court

may not order judgment *n.o.v.* as where the verdict loser has failed to strictly to comply with the procedural requirements of Rule 50(b) or where the record reveals a new trial issue which has not been resolved." (386 U.S. at 325). Further, the *Neely* decision held that, where the court of appeals sets aside the jury's verdict, because the evidence was insufficient to send the case to the jury, it is not so clear that the litigation should be terminated. This latter admonition is clearly applicable to the facts in this case. Besides the government's failure to protect its procedural right to request the circuit court to enter judgment *n.o.v.*, the Eighth Circuit found that the Petitioner had failed to meet his burden of proof on the question of "encumbered funds," when the circuit court determined, for the first time on appeal in this case, a definition of that specific term.

Under these circumstances, and in accordance with this Court's interpretation of the provisions of Rule 50(d) of the FRCP in the *Neely* case, the Petitioner submits that the Eighth Circuit committed clear error in this case by rendering judgment *n.o.v.* for the government, when the government had failed to strictly comply with the procedural requirements of Rule 50. See, Wright & Muller, *Federal Practice and Procedure*, § 2540, Appellate Review.

Therefore, Honey submits that this Court should entertain his Petition on this question, review the record, and reverse and remand the case for a new trial on these factual issues, so as to give specific guidance to the lower federal courts in instances where there is an appeal on factual issues taken from both the verdict of a jury and a district court's opinion, especially where the losing party in the trial court fails to protect its procedural interests.

CONCLUSION

For the reasons set forth above, the Petitioner submits that its Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit should be granted.

Respectfully submitted,

SEPTEMBER 9, 1992

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APPENDIX A

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 91-1782

Charles L. Honey,	*	
	*	
Plaintiff-Appellee,	*	Appeal from the United States
	*	District Court for the
v.	*	Western District of Arkansas.
	*	
United States of America,	*	[PUBLISHED]
	*	
Defendant-Appellant	*	
	*	
	*	
United States of America,	*	
	*	
Counterclaimant-Appellant,	*	
	*	
v.	*	
Charles L. Honey and James W. Meador,	*	
	*	
Counterdefendants-Appellees.	*	

Submitted: December 9, 1991
Filed: May 7, 1992

Before LAY, * Chief Judge, WOLLMAN and HANSEN, Circuit Judges.

HANSEN, Circuit Judge.

Appellant United States of America, on behalf of the Internal Revenue Service (IRS), appeals from an order and judgment of the district court regarding appellees Charles L. Honey (Honey) and James W. Meador's (Meador) (collectively "taxpayers") liability under 26 U.S.C. § 6672 (1986), for withholding taxes unremitted by Phoenix Housing Systems, Inc. (Phoenix). We reverse.

I. BACKGROUND.

Phoenix was incorporated on November 27, 1984, by Honey, Charles White (White), and F. Peter Lee (Lee). Lee, the president and chief executive officer, was responsible for the day-to-day operations of Phoenix. Honey was named vice-president and secretary/treasurer but had few responsibilities other than as legal counsel. White was the bookkeeper for Phoenix. In April of 1985, Meador was hired by Phoenix as vice-president of finance. During the entirety of its existence, Phoenix did not remit any withheld Federal Insurance Contributions Act (FICA) or income taxes to the IRS as required by 26 U.S.C. § § 3102 and 3402 (collectively "employment taxes").

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* The Honorable Donald P. Lay was Chief Judge of the United States Court of Appeals for the Eighth Circuit at the time this case was submitted and took senior status on January 7, 1992, before the opinion was filed.

In late October of 1985, Lee disappeared, and Meador took over the day-to-day operations of Phoenix. Meador discovered in early November that the withheld employment taxes had not been remitted to the IRS. Meador informed Honey that the taxes had not been remitted. [1] The decision was made either by Honey and Meador or by Meador alone with knowledge on Honey's part to pay Phoenix's employees, suppliers, and other general creditors in an effort to continue operations while they sought an investor to purchase Phoenix. [2] Between November 1, 1985, and late December 1985, approximately $114,000 was disbursed from Phoenix's general corporate account with the First National Bank of Hope to pay employees, suppliers, and other general creditors. Approximately the same amount was deposited into Phoenix's account during this period. The corporation's short life ended in late December 1985, when two of Phoenix's lenders seized the corporation's assets.

On June 20, 1988, the IRS assessed Honey, Meador, and Lee for $112,375.49 in unpaid employment taxes for the second, third, and fourth quarters of 1985. Honey paid a portion of the assessed taxes and filed a claim with the IRS for refund and abatement. The IRS disallowed Honey's claim and Honey commenced this suit. The United States countersued Honey, Meador,

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[1] The date on which Honey learned that the withheld employment taxes had not been remitted to the IRS was disputed at trial. Honey testified that he did not learn this information until January of 1986. Meador testified that he told Honey of this fact in early November of 1985. The jury's finding that Honey was willful after October 31, 1985, suggests that the jury did not believe Honey's testimony on this issue.

[2] There was also a factual dispute with regard to whether Honey participated in or had knowledge of the decision to pay other creditors instead of the past due tax obligation. Again, the jury's verdict that Honey was willful after October 31, 1985, necessarily implies that the jury found that Honey did at least have knowledge of that decision.

and Lee for the unpaid portion of the assessment. Lee was subsequently dismissed due to the inability of the United States to obtain service of process.

In order to be personally liable under § 6672 for unpaid employment taxes, a person must be considered "responsible" and must have willfully failed to collect or pay over the taxes. *See Olsen v. United States*, 952 F.2d 236, 239 (8th Cir. 1991); *Kizzier v. United States*, 598 F.2d 1128, 1132 (8th Cir. 1979). Answering interrogatories, the jury found that Honey and Meador were responsible persons for the entirety of the assessed period but had acted willfully only after October 31, 1985. No appeal is taken from the jury's findings.

By agreement, the parties reserved for the court the question of whether Phoenix had any "unencumbered funds" available after October 31, 1985, to pay the taxes collected and due prior to that date. The trial court noted that if unencumbered funds were available to Phoenix after October 31, 1985, and were not used to pay the tax deficiency which accrued prior to that date, are personally liable for the tax deficiency to the extent of the unencumbered funds. *See Kizzier*, 598 F.2d at 1134; *Mazo v. United States*, 591 F.2d 1151, 1154 (5th Cir.), *cert. denied*, 444 U.S. 842 (1979). The trial judge determined that no unencumbered funds were available after October 31, 1985. The United States appeals from the trial judge's ruling that Phoenix had no unencumbered funds after October 31, 1985.

Appellees do not contest their liability for $13,161.10 in employment taxes collected but unremitted during November and December of 1985, and do not appeal from the district court's entry of judgment against them for the unpaid portion of those taxes.

II. DISCUSSION

A. GENERALLY

An employer is required to withhold FICA and federal income taxes from its employees' wages. 26 U.S.C. § § 3102, 3402. Those collected taxes constitute a trust in the hands of the employer. 26 U.S.C. § 7501. The Internal Revenue Code provides:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

26 U.S.C. § 6672(a) (1986).

"A responsible person acts willfully within the meaning of § 6672 whenever he 'acts or fails to act consciously and voluntarily and with knowledge or intent that as a result of his action or inaction trust funds belonging to the government will not be paid over but will be used for other purposes,' . . . [or] by proceeding with a 'reckless disregard of a known or obvious risk that trust funds may not be remitted to the government.' " *Olsen*, 952 F.2d at 240 (citations omitted). "The term willfully does not connote a bad or evil motive, but rather means a voluntary, conscious, and intentional act, such as the payment of other creditors in preference to the United States." *Elmore v. United States*, 843 F.2d 1128, 1132 (8th Cir. 1988).

The parties dispute whether the trial court placed the burden on the United States to prove that unencumbered funds were available or placed the burden on the taxpayers to prove that all funds available were unencumbered. The failure to use unencumbered funds to satisfy a preexisting employment tax liability is part of being willful. Although willfulness is usually a question of fact, "[e]vidence that the responsible person had knowledge of payments to other creditors, including employees, after he was aware of the failure to pay over withholding taxes is proof of willfulness as a matter of law." *Olsen*, 952 F.2d at 240 (citations omitted). *See also Hochstein v. United States*, 900 F.2d 543, 548 (2d Cir. 1990). Once the IRS makes an assessment of liability, the taxpayer bears the burdens of production and persuasion as to all issues, including the lack of willfulness. *Ruth v. United States*, 823 F.2d 1091, 1093 (7th Cir. 1987) (citing cases); *Anderson v. United States*, 561 F.2d 162, 165 (8th Cir. 1977). Thus, the taxpayer has the burden to prove that all potentially available funds were encumbered. *Cf. Mazo*, 591 F.2d at 1156 n. 2 ("The taxpayers neither alleged nor offered any evidence that these funds [in the bank account] were encumbered or otherwise restricted so that they were unavailable for payment of withholding taxes.").

During the trial, the district court noted on several occasions that the burden of proof, including the burden "to show that funds were not available," was on the taxpayers. Although not explicit in the written order, we find that the trial court did place the burden on the taxpayers to prove that the available funds were encumbered.

The district court's conclusion that no unencumbered funds existed is a mixed question of law and fact. The definition of "unencumbered" is a legal issue subject to de novo determination. The factual question is whether any funds meeting that definition existed. As will be discussed, under the facts of this case, we conclude as a matter of law that Phoenix had adequate unencumbered funds after October 31, 1985, to satisfy the tax obligation which had accrued prior to October 31, 1985.

B. THE RELATIONSHIP BETWEEN BEING A "RESPONSIBLE PERSON," BEING "WILLFUL," AND UNENCUMBERED FUNDS

The taxpayers argue that they are liable only to the extent of the unencumbered funds in existence *on* October 31, 1985, and not for any funds acquired by Phoenix *after* October 31, 1985. However, the taxpayers have not challenged the district court's ruling against them on this issue by filing a cross-appeal. We discuss this issue solely for the purpose of lending meaning to our later discussion of the definition of "unencumbered funds" under the facts of this case.

The taxpayers cite to *Slodov v. United States*, 436 U.S. 238 (1978), wherein the United States Supreme Court rejected the government's argument that a trust to pay the preexisting tax liabilities was imposed on all cash received by the corporations after a taxpayer assumes control of a corporation and becomes both responsible and willful.

> [A] "responsible person" under § 6672 may violate the "pay over" requirement of that statute by willfully failing to pay over trust funds collected prior to his accession to control when at the time he assumed control the corporation has funds impressed with a trust under § 7501, but that § 7501 does not impress a trust on after-acquired funds, and that the responsible person consequently does not violate § 6672 by willfully using employer funds for purposes other than satisfaction of the trust-fund tax claims of the United States when at the time he assumed control there were no funds with which to satisfy the tax obligation and the funds thereafter generated are not directly traceable to collected taxes referred to by that statute.

Slodov, 436 U.S. at 259–60.

In *Elmore v. United States*, we applied *Slodov* and found that at the time Elmore simultaneously became both responsible and willful, the corporation's bank balance was positive but was encumbered by outstanding checks written *prior* to the time Elmore became both responsible and willful, and thus Elmore was not liable under § 6672. *Elmore*, 843 F.2d 1128, 1133 (8th Cir. 1988). In *Kenagy v. United States*, we expanded upon this point:

> A responsible person generally may not be penalized with respect to unpaid taxes accruing prior to the date s/he became a responsible person in an amount more than the unencumbered funds of the corporation in existence at that date. Unencumbered funds are those funds available after taking into account outstanding transactions.

Kenagy, 942 F.2d 459, 465 (8th Cir. 1991) (citing *Slodov* and *Elmore*).

However, the facts of *Slodov*, *Elmore* and *Kenagy* are distinguishable from the facts of this case. Those cases look to the point in time at which the taxpayer became a responsible person and look to whether there were unencumbered funds available as of that date to pay the tax liability accrued prior to the time the taxpayer became a responsible person. If such unencumbered funds exist, the taxpayer is personally liable under § 6672 for the tax liability to the extent of any unencumbered funds used for any purpose other than satisfying that liability.

The facts of our decision in *Kizzier* are very similar to this case. Kizzier was the sole shareholder and the president and treasurer of Titan, a corporation. *Kizzier* was assessed under § 6672 for unremitted employment taxes for the last quarter of 1973 and the first three quarters of 1974. Kizzier was a responsible person throughout the entirety of this period. In March of 1974,

Kizzier first learned that Titan had not remitted its previously withheld employment taxes to the IRS. Citing *Mazo v. United States*, 591 F.2d 1151 (5th Cir.), *cert. denied*, 444 U.S. 843 (1979), we held that "Kizzier's responsibility to pay Titan's withheld employment taxes extended to unencumbered funds received by the corporation after Kizzier learned of Titan's tax delinquency." *Kizzier*, 598 F.2d at 1134. *Olsen* also involved a taxpayer who was both responsible and willful for the entirety of the period during which employment taxes were collected but not remitted. Olsen, 952 F.2d at 240–241.

In this case, the jury found that Honey and Meador were responsible persons during the entire time the employment tax liabilities accrued. The jury also found that Honey and Meador did not act willfully until after October 31, 1985. In making this latter finding, it is likely, based on the instructions given the jury, that the jury found that Honey and Meador were not aware of the failure to pay over the employment taxes withheld prior to October 31, 1985, until Meador took over the daily operations of Phoenix and were thus not "willful" prior to that date, but that Honey and Meador were "willful" after October 31, 1985, because they did not collect, account for, and pay over employment taxes accruing after that date. However, "[e]vidence that the responsible person had knowledge of payments to other creditors, including employees, after he was aware of the failure to pay over withholding taxes is proof of willfulness as a matter of law." *Olsen*, 952 F.2d at 240. That aspect of willfulness was not submitted to the jury and was the issue reserved for the district court. The jury's findings are relevant to the question of when Honey and Meador had knowledge that the employment taxes had not been paid over and the question of whether Honey and Meador acted willfully with respect to employment tax liabilities accrued after October 31, 1985. The jury's findings are not dispositive of whether or not Honey and Meador acted willfully in failing to use unencumbered funds acquired after October 31, 1985, to satisfy the tax liability which had accrued prior to that date. The jury was not instructed on or asked to resolve the issue of whether Phoenix had

unencumbered funds after October 31, 1985.

Since Honey and Meador were responsible persons when the employment tax liabilities accrued, we apply the following rule:

> Thus, "[i]n the case of individuals who are responsible persons both before and after the withholding tax liability accrues . . . there is a duty to use unencumbered funds acquired after the withholding obligation becomes payable to satisfy that obligation; failure to do so when there is knowledge of the liability . . . constitutes willfulness."

Olsen, 952 F.2d at 240 (citations omitted). *See also Thomsen v. United States*, 887 F.2d 12, 17–18 (1st Cir. 1989); *Howard v. United States*, 711 F.2d 729, 736 (5th Cir. 1983). *Slodov's* "holding regarding liability for failure to apply after-acquired funds to withholding taxes is limited to the situation of an individual becoming a responsible person after those taxes are payable and trust funds have been dissipated." *Mazo*, 591 F.2d at 1157. *See also Kizzier*, 598 F.2d at 1133–34; *Davis v. United States*, No. 90–16209, 1991 WL 72121 at *3–11 (9th Cir. Apr. 14, 1992). Thus, Honey and Meador are liable under § 6672 to the extent that Phoenix used unencumbered funds after October 31, 1985, to pay creditors in preference of the IRS.

The taxpayers also cite to *Matter of King*, 91–2 U.S. Tax. Cas. (CCH) P50, 330, 68 A.F.T.R.2d (P–H) 5249 (Bankr. S.D. Ala. 1991). Although King had been a responsible person throughout the entirety of the corporation's existence, the court concluded that he was liable for unpaid employment taxes only to the extent of the unencumbered funds in existence on the date he became willful by acquiring actual knowledge that the taxes had not been paid. *King* does not recognize that the key issue is when the taxpayer became a responsible person, not when the taxpayer acquired actual knowledge that employment taxes are not being

remitted to the IRS. Accordingly, we do not find *King* persuasive.

C. THE DEFINITION OF "UNENCUMBERED FUNDS"

This case requires us to set forth a more precise definition of "unencumbered funds." In *Kenagy*, we stated that "[u]nencumbered funds are those funds available after taking into account outstanding transactions." *Kenagy*, 942 F.2d at 465. However, the definition of "unencumbered funds" was not a central issue in *Kenagy*. *Kenagy's* definition of "unencumbered" serves when the issue is whether any unencumbered funds existed as of the moment the taxpayer becomes a responsible person. That definition is not as helpful when applied to the factual situation we now face. In our previous cases presenting similar factual circumstances, *Kizzier* and *Olsen*, we did not have occasion to specifically define "unencumbered funds."

In defining "unencumbered funds," we must keep the purpose of § 6672 in mind.

> [Section] 6672 "is simply a means of ensuring that the tax is paid." . . . In keeping with this purpose, § 6672 has been broadly and liberally construed "to prevent the unnecessary loss of tax funds by permitting the 'taxing authority to reach those responsible for the corporation's failure to pay the taxes which are owing.' "

Olsen, 952 F.2d at 239 (citations omitted). Thus, our definition of "encumbered funds" should be a broad one in order to ensure that the taxes are paid.

The case law offering a more precise definition for "unencumbered funds" is sparse. *In re Premo*, 116 B.R. 515 (Bankr. E. D. Mich. 1990) sets forth the following definition:

> Where the taxpayer's discretion in the use of funds is subject to restrictions imposed by a creditor holding a security interest in the funds which is superior to any interest claimed by the IRS, the funds are regarded as unencumbered if those restrictions preclude the taxpayer from using the funds to pay the trust fund taxes.

Id. at 535. [3] The essential point of this definition is that funds are encumbered only where the taxpayer is legally obligated to use the funds for a purpose other than satisfying the preexisting employment tax liability and if that legal obligation is superior to the interest of the IRS in the funds.

We agree with *Premo's* definition of "unencumbered funds," although we recognize that *Premo* involves a *Slodov* fact pattern but applies the rule of *Mazo* and *Kizzier*. We do not find, however, that Premo's failure to distinguish these two very different situations should cause us to reject *Premo's* definition of unencumbered funds. *Premo's* definition is consistent with the purpose of § 6672 and is clear in its application. Thus, we adopt this definition of "unencumbered funds." We now turn to the application of this definition to the facts of this case.

D. THE SECURITY INTEREST IN PROCEEDS

The taxpayers argue for affirmance on a basis not specifically addressed by the district court's order. It is unclear from the record whether or not the taxpayers raised this argument in the court below. However, [w]e may affirm a judgment on any ground supported by the record even if not relied upon by the district court." *Lane v. Peterson*, 899 F.2d 737, 742 (8th Cir.)

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[3] We note that Premo a bankruptcy case, places the burden on the IRS as a creditor to prove that the funds were unencumbered. See Premo, 116 B.R. at 518–24. We do not discuss this aspect of Premo.

(citations omitted, *cert. denied*, 111 S. Ct. 74 (1990). We also note that appellant has not argued that review of this contention is precluded by any failure to previously raise this issue.

On August 28, 1985, Phoenix obtained a loan in the amount of $90,390.41 from the Merchants & Planters Bank & Trust Company (Merchants). Merchants took a security interest in all of Phoenix's inventory, as well as any proceeds from the sale of such inventory. Honey and Meador argue that all of the funds deposited to Phoenix's account were proceeds from the sale of inventory and were encumbered by Merchants' security interest. As previously discussed, Honey and Meador bear the burden of proving that the funds were encumbered. Charles White, the Phoenix accountant, testified that there were monies received during October, November, and December of 1985, that could have been diverted to payroll taxes, but White could not say that the entire payroll tax liability could have been paid. He also testified that he had no knowledge that the funds were encumbered but could not definitely say they were not encumbered. Meador testified that he did not know if these funds were encumbered.

Honey and Meador have not specifically pointed to any evidence in the record proving that any of the money deposited in Phoenix's account was proceeds from the sale of inventory. The only evidence of record suggesting that some of the money deposited was from the sale of inventory is Meador's testimony that Phoenix continued to manufacture and sell houses. The only specific evidence of record as to the source of deposits is that $20,000 deposited on December 20, 1985, was money personally borrowed by Meador from the Bank of Yellville and loaned by Meador to Phoenix. [4] Meador also testified that he put other personal funds into Phoenix, but he did not testify as to when he

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[4] Although there is evidence in the record that the purpose of the loan was to make payroll, there is no evidence that there was any legal obligation attached to that loan to use it only for payroll.

gave or loaned the corporation those funds or as to the amount of any such funds. Thus, Honey and Meador have not met their burden of proof with respect to the actual amount of funds deposited to Phoenix's account which represented proceeds from the sale of inventory. We find, however, that the evidence permits a reasonable inference that some funds deposited were proceeds from the sale of inventory.

Under our test for "unencumbered funds," we are required to ascertain whether Merchants' security interest in proceeds is superior to the interest claimed by the IRS in the funds deposited in Phoenix's account. To do so, we must determine the nature of the IRS's interest in those funds.

> Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States.

26 U.S.C. § 7501(a). The trust established by § 7501 is created when wages to the employees are paid. *Begier v. Internal Revenue Serv.*, 110 S. Ct. 2258, 2264 (1990). Generally, funds held in trust under § 7501 are not required to be segregated or specifically identified. *Id.* at 2264. Under some circumstances, the IRS may require that collected employment taxes be segregated in a separate bank account until paid over to the IRS. *See* 26 U.S.C. § 7512. The IRS did not invoke the provisions of § 7512 in this case. Thus, the funds in Phoenix's general corporation account were not specifically identified as trust fund amounts.

Neither did the IRS place a lien on the assets of Phoenix prior to the termination of the corporation's existence, as is provided for in 26 U.S.C. § 6321. The lien under § 6321 generally arises only after the United States make an assessment for the taxes. *See* 26 U.S.C. § 6322. There is no evidence that an

assessment for the unremitted employment taxes was made prior to the termination of the corporation's existence. Even if the IRS had obtained a tax lien under § 6321, a tax lien is subordinate to "certain perfected security interests in certain collateral, including inventory, arising after the tax lien filing when pursuant to a security agreement entered into before the filing." *Slodov*, 436 U.S. at 257; 26 U.S.C. § 6323(c). The IRS never filed a tax lien, and no argument is made that Merchants' security interest was not perfected. We find that Merchants' security interest in proceeds was superior to the interest of the IRS in the funds in Phoenix's corporate account to the extent that those funds actually were proceeds from the sale of inventory.

We must next consider whether Merchants' security interest would have presented the use of the funds in Phoenix's account for the payment of the tax obligation. Paragraph 6 of the security agreement between Merchants and Phoenix provides that upon Merchants' demand, Phoenix would be required to deposit all payments for inventory sold "in a special bank account maintained with Bank, over which Bank alone has power of withdrawal." Inventory security agreement, para. 6. Except for paragraph 6, the security agreement contains no restrictions on Phoenix's use of the proceeds from the sale of inventory. There is no evidence that Merchants ever invoked paragraph 6. We also note that Doyle Brewer, assistance vice-president for the First National Bank of Hope, testified that he did not know of any restrictions on Phoenix's account which would have prevented the use of funds in that account for payment of the employment tax liabilities. Thus, applying our definition of unencumbered funds, the security agreement, except for the uninvoked paragraph 6, did not place any restrictions on Phoenix's use of the funds in Phoenix's account that would have precluded payment of the tax liability.

We also note that once funds were disbursed from Phoenix's account to pay other creditors, Merchants' security interest in those funds would have been extinguished. A security interest in proceeds from inventory is continuously perfected if the security

interest in the inventory was perfected, but ceases to be perfected twenty–one days after receipt of the proceeds by the debtor unless "a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds." Ark. Code Ann. 4–9–306(3) (1987). [5] However, "a security interest in proceeds remain[ing] in a bank account continues until the funds are actually transferred in the ordinary course of business." *Anderson, Clayton & Co. v. First Am. Bank of Erick*, 614 P.2d 1091, 1094 (Okla. 1980). *See also Citizens Nat'l Bank of Whitley County v. Mid–States Dev. Co., Inc.*, 380 N.E.2d 1243, 1250 (Ind. Ct. App. 1978); U.C.C. § 9–306 cmt. 2(c)., 3 U.L.A. 441 (1981).

We find as a matter of law that while Merchants' security interest in Phoenix's account, to the extent that that account contained proceeds from the sale of inventory, was superior to the interest of the IRS in those funds, there is no evidence that Merchants restric ed Phoenix's ability to use those funds to satisfy the preexisting ta c obligation.

There is also evidence in the record that some proceeds from the sale of homes were made payable jointly to Phoenix and B&R Builders Supply, who was Phoenix's main supplier, and delivered to B&R to cover their materials, with the remainder paid to Phoenix. No argument or evidence has been presented that B&R Builders Supply had any interest in the funds on deposit in Phoenix's corporate account.

E. VIS–A–VIS OTHER GENERAL CREDITORS

We next consider whether the employees, suppliers, and utilities had an interest in the funds superior to the IRS's interest. Honey and Meador have presented no evidence or argument that Phoenix had any legal obligation to use available funds to pay

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[5] We do not address the question of whether any funds in the account were "identifiable cash proceeds."

employees, suppliers, and utilities which was superior to its obligation to remit the unpaid employment taxes to the IRS. In Olsen, as in other cases, we held without hesitation that Olsen acted willfully in paying employees and creditors other than the IRS in preference to the payment of the unsatisfied employment tax liability. *See Olsen*, 952 F.2d at 241. We hold as a matter of law that the interests and rights of the general creditors who were paid from Phoenix's funds were not superior to the interests and rights of the IRS to payment of the unsatisfied employment tax liability.

F. THE TRIAL COURT'S ANALYSIS

In finding that Phoenix had no unencumbered funds after October 31, 1985, the trial court rejected the government's proposal that the court determine the amount of unencumbered funds by adding up the money deposited to or withdrawn from Phoenix's corporate account after October 31, 1985. The trial court set forth a hypothetical in which the use of funds to pay employees and suppliers generates more funds which are used to pay employees and suppliers, ad infinitum, and reasoned that the government's proposed method of proof could result in multiple counting. [6] The court below further found that deposits to the account were encumbered because all of the checks written on Phoenix's account were "force paid" during October, November, and December of 1985. In other words, when checks were presented to the bank for payment there were no funds in the account. The bank held the checks until deposits were made to cover the checks. The trial

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[6] The following is a shortened version of the trial court's hypothetical. Assume that the corporation starts with $1,000 in its account. On Day 1 it buys $900 worth of supplies and pays its employees $100 to build its product. On Day 2 it sells its product for $1,100 and deposits that money in its account. On Day 3 it buys $900 worth of supplies and pays the employees $100 to build another product. On Day 4 it sells that product for $1,100 and deposits that money in its account. At that point, the corporation has spent $2,000 from its account and has deposited $2,200. However, the corporation only has actual funds of $1,200.

court reasoned that since funds were subject to the outstanding checks when deposited, those funds were encumbered.

We do not accept the trial court's view that all of the funds in Phoenix's account were "encumbered" because the checks were "force paid." In reaching that conclusion, the trial court appears to have relied on *Elmore*, which is factually dissimilar. In *Elmore*, the funds in the bank account were considered encumbered only because the checks against those funds were written *prior* to the time Elmore became a responsible person. In this case, the checks which were "force paid" were written long after Honey and Meador became responsible persons and after the conscious decision was made to use Phoenix's funds to pay creditors other than the IRS. Further, when a person is responsible when the taxes are accrued, we see no distinction between a situation where checks are written before the money to cover those checks is deposited and a situation where the checks are written after the money is deposited. Thus, whether or not checks were "force paid" is irrelevant under the facts of this case.

We also disagree with the trial court's conclusion that the possibility of multiple counting precludes the method of proof as to the amount of unencumbered funds proposed by the government. Honey and Meador argue that it is likely that if Phoenix had attempted to pay the IRS instead of its suppliers, utilities and employees, the corporation would have folded immediately and no further sales would have been made, and therefore much of the income received in November and December would not have been earned and would not have been available to pay the back taxes. While there is some appeal in this line of analysis, "[i]t is no excuse that, as a matter of sound business judgment, the money was paid to suppliers and for wages in order to keep the corporation operating as a going concern -- the government cannot be made an unwilling partner in a floundering business." *Collins v. United States*, 848 F.2d 740, 741-42 (6th Cir. 1988). *See also Thibodeau v. United States*, 828 F.2d 1499, 1506 (11th Cir. 1987); *Mazo*, 591 F.2d at 1154 (citing cases). With regard to

Honey and Meador's argument that it may be in the best interest of the IRS to keep a financially troubled corporation operational in the hopes that the corporation's finances will improve, there is no evidence in the record that Honey and Meador negotiated with the IRS to waive the IRS's claim under § 6672 in the hope that Phoenix would survive. *Cf. Donelan Phelps & Co., Inc. v. United States*, 876 F.2d 1373, 1377 (8th Cir. 1989). Finally, even if we were to accept the theoretical possibility of multiple counting, the taxpayers would bear the burden of proving that multiple counting actually occurred in this case. Honey and Meador have not met that burden.

G. THE PROPER REMEDY

Honey contends that this court may not reverse and direct that judgment be entered for appellant but may only reverse and remand for a new trial. Honey argues that appellant failed to move for a directed verdict or for judgment notwithstanding the verdict and that that failure limits our options on appeal. We firs note that our review of the record discloses that counsel for the government did move for a directed verdict at the close of the case presented by Honey and Meador with respect to both of them and at the close of all of the evidence with respect to Honey only. Second, appellant appeals from the order of the district court regarding whether Phoenix's funds were unencumbered and primarily raises a question of law. To the extent that this appeal raises questions of fact, those questions were reserved to the district court by agreement among the parties. Appellant does not appeal from the jury's findings. Thus, Federal Rule of Civil Procedure 50 regarding motions for directed verdict and for judgment notwithstanding the verdict is not applicable. We do not find our options as limited as counsel for Honey suggests.

III. CONCLUSION

We hold, as a matter of law, that the taxpayers have not met their burden to prove by a preponderance of the evidence that

any of the funds deposited or withdrawn from Phoenix's corporate account after October 31, 1985, were encumbered. Accordingly, we reverse the order and judgment of the district court and remand with directions to enter judgment in favor of the United States for the assessed employment tax liability which remains unpaid, plus interest as allowed by law.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
TEXARKANA DIVISION

CHARLES L. HONEY — PLAINTIFF

v. Civil No. 89–4108

UNITED STATES OF AMERICA — DEFENDANTS

UNITED STATES OF AMERICA — COUNTERCLAIMANT

v.

CHARLES L. HONEY, JAMES W. MEADOR and FELIX P. LEE — COUNTERDEFENDANT

MEMORANDUM OPINION

Background and Issues

This case was tried before a jury in May, 1990. By agreement of the parties, the court is to decide how much penalty, if any, is due to the government. The parties have submitted post-trial briefs and reply briefs.

In interrogatories, the jury found that Charles Honey and James Meador, officers of Phoenix Housing Systems, were responsible for paying withholding taxes in the second, third, and fourth quarters of 1985, that their failure to pay those withholding taxes was willful only in the fourth quarter, and that their willful failure

to pay [1] spanned the period between October 31 and December 31, 1985. The parties disagree on how to allocate certain advances made to the corporation's officers during the second and third quarters of 1985, on whether officers may be liable for periods before willfulness began if they were responsible for paying withholding taxes in those periods, and on the amount of unencumbered funds available on or after October 31, 1985.

The jury's finding that plaintiffs were responsible and willfully failed to pay over taxes as of October 31, 1985, clearly obligates plaintiffs to satisfy the 100% penalty due pursuant to 26 U.S.C. § 6672 for November and December of 1985. The court must determine the amount of this penalty. A more difficult question in this case is whether plaintiffs Charles Honey and James Meador must also satisfy the penalty assessed for those periods that the jury found plaintiffs were responsible but not willful, that is the second, third and beginning of the fourth quarter of 1985. The court believes that under the law taxpayers are obligated to use only unencumbered funds, including those acquired after learning of delinquent tax liabilities, to satisfy those liabilities. *See Slodov* v. United States, 436 U.S. 238 (1978); *Elmore v. United States*, 843 F.2d 1128-1132 (8th Cir. 1988). The jury's answers to the special interrogatories indicate that plaintiffs became aware of their accrued tax liability as of October 31, 1985, the date the president of the company, F. Peter Lee, mysteriously disappeared. Accordingly, for the second, third, and beginning of the fourth quarter of 1985 the plaintiffs are legally obligated to pay a tax penalty not to exceed the amount of all unencumbered funds available between October 31 and December 31 of 1985.

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[1] The interrogatory actually asked on what date each person "became a responsible officer" in that quarter. All parties seem to interpret this as a finding that the period specified is the period of willfulness. Since the jury had already found that both persons were responsible for paying withholding taxes in all three quarters, presuming that the period specified is that of the willful failure to pay is the only construction of the jury's finding that makes sense.

I. Liability for Periods of Responsibility But before Willfulness

The Internal Revenue Code, 26 U.S.C. § 3401 et. seq. directs employers to collect both income and FICA taxes from their employees. These sums are commonly referred to as "trust funds" because the Code provides that they are deemed to be a "special fund [held] in trust for the United States." 26 U.S.C. § 7501. In order for an officer or employee to be held liable under 26 U.S.C. § 6672, two requirements must be satisfied:

> (1) the party assessed must be a person required to collect, truthfully account for and pay over the tax, referred to in the parlance as a "responsible person" and (2) such person must have willfully failed to ensure the withholding taxes were paid. *Kizzier v. United States*, 498 F.2d 1128, 1132 (8th Cir. 1979); *Hartman [v. United States]*, 538 F.2d 1336, 1340 (8th Cir. 1976).

Elmore v. United States, 843 F.2d 1128, 1132 (8th Cir. 1988).

The jury found that plaintiffs were responsible persons during all relevant quarters but plaintiffs argue that the jury's finding that plaintiffs' failure to pay the taxes was not willful during the second and third quarters of 1985 relieves them of liability for withholding taxes accrued during those periods. Plaintiffs cite the Supreme Court's decision in *Slodov v. United States*, 436 U.S. 238 (1978) and the Eighth Circuit's holding in *Elmore v. United States*, 843 F.2d 1128 (1988) to support this proposition. In both these cases, however, the facts are distinguishable from the facts here because in both cases the taxpayers were not deemed "responsible" persons within the meaning of § 6672 for those quarters for which tax liability was excused.

Slodov involved an orthodontist who, having no prior connection with three food vending businesses, bought their stock. As soon as the orthodontist took control of the businesses he found that the businesses had accrued a $250,000 liability for past due withholding taxes. The Court held that funds collected after a change in corporate control are not impressed with a trust for taxes withheld during a prior regime unless those funds are directly traceable to dissipated trust funds; and that failure to use such later acquired funds to pay federal withholding taxes does not constitute a violation of the § 6672 requirement that the responsible person "pay over" withholding taxes. *See* 436 U.S. at 258. The court in *Slodov* specifically limited its holding to funds acquired after the responsible persons "accession to control." 436 U.S. at 258–259. In *Slodov*, then, the Court confronted the situation of a party becoming a responsible person, within the meaning of 26 U.S.C. § 6672, after the corporation had incurred a tax liability and had expended funds available to pay the liability. *Kizzier v. United States*, 598 F.2d 1128, 1134 (8th Cir. 1979). In the present case, however, the jury found that plaintiffs were responsible persons throughout the entire period over which Phoenix Housing acquired its tax liability.

In *Elmore* the Eighth Circuit faced a situation where the jury found the defendant neither responsible nor willful for the second and third quarters of 1980, but found him both responsible and willful for the remaining quarters. The court held that "[i]n similarity to *Slodov*, however, the jury here undoubtably found a change in corporate control had occurred." *Elmore v. United States*, 843 F.2d 1128 (8th Cir. 1988). So long as there is no change in the control of the corporation, the Eighth Circuit's decision in *Kizzier v. United States* applies. There, the court found:

> Although [the plaintiff] did not become aware of [the corporation's] tax delinquency until March 1974, he was a responsible person ... through all the calendar quarters [the corporation] failed to

> pay over employment taxes to the Government. As such, [the plaintiff's] responsibility to pay [the corporation's] withheld employment taxes extended to unencumbered funds received by the corporation *after* [the plaintiff] learned of [the corporation's] tax delinquency.

Kizzier, 598 F.2d at 1138. In *Kizzier* the Eighth Circuit adopted the reasoning previously enunciated by *Mazo v. United States*, 591 F.2d 1151 (5th Cir. 1979):

> Where there has been no change in control, however, responsible persons are subject to a duty to apply any available unencumbered funds to reduction of accrued withholding tax liability, whether or not those funds are deemed to be trust funds within the meaning of § 7501.

Kizzier, 598 F.2d at 1134 (quoting *Mazo*, other citations omitted).

Thus, plaintiffs are subject to a 100% penalty of unpaid taxes between January 1 to October 31, 1985, but this penalty may not be greater than the unencumbered funds available to Phoenix Housing on or after October 31, 1985, the date the jury found them to be both responsible and willful within the meaning of 26 U.S.C. § 6672. For in none of the cases cited in the government's extensive post trial briefs has a taxpayer been personally obligated to pay a tax liability which accrued prior to the period of willfulness when there were no unencumbered corporate funds available to pay the accrued tax liability. See e.g., Elmore, 813 F.2d at 1132.

II. Unencumbered Funds Available
Between October 31 and December 31, 1985

Though plaintiffs are liable to pay the entire tax penalty which accrued during the second, third, and first month of the fourth quarter of 1985, to the extent that unencumbered funds were

available during the period of willfulness, a most difficult question is still presented by this case, that is whether, and in what amount, unencumbered funds were available with which plaintiffs could have paid the corporation's liabilities after they became aware of them on October 31, 1985.

In determining the liability for accrued taxes owed to the government, the Supreme Court has emphasized as a critical consideration whether the failing corporation had "funds," *see, e.g.*, *Slodov*, 436 U.S. at 242, 259, 260, 98 S. Ct. at 1782–83, 1791, "liquid assets," *id.* at 242, 246, 251 or "cash," *id.* at 251, on hand when the responsible person assumed control of the enterprise. In this case one cannot look to the cash on hand as of the second quarter of 1985 since the jury findings indicate that plaintiffs were not even aware of the liability until October 31, 1985, and so had no knowledge that the tax debt had to be paid. Thus the question here is whether there were unencumbered assets as of or after October 31, 1985. "As administered by the IRS, section 6672 brings to the government only the same amount to which it was entitled by way of the tax," and "is simply a means of insuring that the tax is paid." *Purdy Co. of Illinois v. United States*, 814 F.2d 1183, 1186 (7th Cir. 1983) (citations omitted).

Although the amount owed is called a "penalty," section 6672 is not meant to punish the unwary by requiring them to pay over money acquired and dissipated before they were aware it was owed to the government. *See Slodov*, 436 U.S. at 254. The government argues in this case that the court should simply add up the dollar deposited to or withdrawn from the corporate account after October 31, 1985 in order to determine the level of unencumbered funds. In this way the defendants contend that there were over $114,000 in unencumbered funds with which plaintiffs could have paid their accrued withholding tax liability. Since the IRS assessed a penalty of $112,375.49, plaintiffs would, under the defendants' theory, be required to pay the entire penalty. The defendants' proposal, however, is unsuitable as it would enable the government to recover funds which were never actually available

in the businesses' accounts during the months that plaintiffs willfully failed to pay the accrued withholding tax liability.

Because the government's test perhaps has about it a deceptive area of rectitude and equity, and might therefore seem to be one that the court should adopt, the court will devote some discussion to demonstrating the unreliability of its proposed method.

By simply adding up withdrawals and deposits as the government proposes that the court do, there is a risk of multiple counting which is manifestly unacceptable. To understand this, consider the bank account of the following hypothetical business. Let this business have $1,000 in deposits on the day before it finds out it has a tax liability of $20,000. If it manufactures its product on day 1 by buying $900 worth of supplies and payi ıg $100 to its employees, the company is able to sell that product for $1,100 on day 2. The company spends $900.00 for mor(materials and $100 for more labor on day 3. Then the company can again sell the product on day 4 for $1,100. If this same transaction pattern occurred for one month, the bank's deposit and withdrawal records would probably look like this:

Day	Deposits	Withdrawals	Balance
0.	$1,000	$ 0	$1,000
1.	0	1,000	0
2.	1,100	0	1,100
3.	0	1,000	100
4.	1,100	0	1,200
5.	0	1,000	200
6.	1,100	0	1,300
7.	0	1,000	300
8.	1,100	0	1,400
9.	0	1,000	400
10.	1,100	0	1,500
11.	0	1,000	500

12.	1,100	0	1,600
13.	0	1,000	600
14.	1,100	0	1,700
15.	0	1,000	700
16.	1,100	0	1,800
17.	0	1,000	800
18.	1,100	0	1,900
19.	0	1,000	900
20.	1,100	0	2,000
21.	0	1,000	1,000
22.	1,100	0	2,100
23.	0	1,000	1,100
24.	1,100	0	2,200
25.	0	1,000	1,200
26.	1,100	0	2,300
27.	0	1,000	1,300
28.	1,100	0	2,400
29.	0	1,000	1,400
30.	1,100	0	2,500
TOTAL	$17,500	$15,000	

DEPOSITS/WITHDRAWALS

The government's proposal that one can simply add up the deposits or the withdrawals that went to any creditor but the IRS, would, for this hypothetical company, result in the finding that there were at least $15,000 in unencumbered funds available for payment of the tax lien. But it is perfectly clear that the hypothetical company never had more than $2500 with which it could have paid its debts. If the government had used the ordinary procedures of notice and demand, moreover, they could have placed a lien on the property of Phoenix Housing System at a much earlier stage. But if they are permitted to sum up the deposits and the withdrawals in a bank account, the government will always profit enormously from not stopping, notifying, and placing a lien on a failing business at the earliest possible date.

Such is not the intent of the Tax Code. *See generally Slodov*, 436 U.S. at 242 *et. seq.*

The inadequacy of the government's method of accounting for available funds in this case is shown even more clearly by the unchallenged testimony of the defendant's own witness, Mr. Doyle Brewer, Vice President of the First National Bank of Hope, Arkansas, the bank in which these deposits and withdrawals were made. Mr. Brewer testified that for all days in October, November and December of 1985, the checks issued by Phoenix Housing Systems, Inc., that were presented to the bank for payment, were "force paid.' This term means that there were no funds available in Phoenix Housing Systems' bank account to pay the checks as they were presented. Instead, the checks were held, deposits were made to cover those checks, and the amounts of the checks were then cleared. Thus, the balance of the withdrawals and deposits made on any given day had little or no bear ng on the extent of unencumbered funds available to the compan' '.

Because there are limits on the power of the IRS to defeat competing creditors in pursuit of company assets, *see Slodov*, 436 U.S. at 256–259 (outlining various limits on the power of the IRS under § 6672), this court cannot impose personal liability on the plaintiffs for their failure to use already encumbered funds to pay the company's tax liability, especially where as here those funds were encumbered before either Honey or Meador were aware of the debt. "[I]t would be inconsistent to impose personal liability for paying after acquired funds to a secured creditor over whom the IRS did not even claim priority." *Purdy Co. of Illinois v. United States*, 813 F.2d 1183, 1990 (7th Cir. 1987) (citing *Slodov*, 436 U.S. at 259). As the *Slodov* Court noted, it is plain that

> ... Congress did not intend § 6672 to hammer the responsible person with the threat of heavy civil and criminal penalties to pay over proceeds in which the IRS does not assert an interest.

Slodov, 436 U.S. at 259. Thus defendants are not entitled to recover personally from the plaintiffs for funds which they could not have wrested from Phoenix Housing Systems by any of the usual procedures, including that of taking a lien and forcing a sale after assessment, notice, and demand. *See Slodov*, 436 U.S. at 243–45 (describing the ways that the IRS can effect payment of withheld taxes).

Upon review of the evidence introduced at trial, and the parties' post trial briefs as to liability, the court finds that Phoenix Housing Systems had no unencumbered funds with which to satisfy the accrued withholding tax liability. Accordingly, plaintiff will be personally liable only for the unpaid tax liability which accrued between October 31, 1990, and December 31, 1990.

III. Withholding Tax Liability
For November and December of 1985

Because the record contains evidence indicating that the company had no unencumbered funds with which plaintiff could have paid the tax liability which accrued prior to October 31, 1985, plaintiff's personal liability under § 6672 is limited to the amount of payroll taxes that should have been withheld from wages paid to employees of Phoenix Housing Systems on payrolls made by the company after October 31, 1985.

The government argues that the plaintiff should also be liable for certain advances made to officers prior to October 31, 1985. But since these advances became payable and taxable as wages at the time they were made, that is prior to October 31, 1985, these wages will not be included in the gross wage calculation for November and December of 1985. The payroll records of Phoenix Housing Systems reflect that the payrolls actually made by Phoenix Housing Systems for periods on or after October 31, 1985, were made on November 1, 8, 15, 20 and 29, 1985; and December 6, 13, and 20, 1985. (The checks for the December 27, 1985 payroll and the January 3, 1986, payroll, were never actually issued

by the company.) The payroll amount totals $111,507.33. (See GX 21, PX 1, p. 2). Having reviewed the evidence produced at trial, and post-trial briefs, the court finds that Honey and Meador have shown that Phoenix Housing Systems, Inc. failed to pay over $13,161.00 in withheld federal income and FICA taxes. Honey and Meador are jointly and severally liable for that amount.

Against this amount of $13,161.10 plaintiff Charles Honey has paid $150.00 and plaintiff James W. Meador has paid $1,000.00. Thus, the total tax liability remaining against Honey and Meador on the government's counterclaim is $12,011.10. Accordingly, judgment will be entered for the government in the amount of $12,011.10 plus interest as provided by law.

31 Jan., 1991
Date

/s/
HON. MORRIS S. ARNOLD
UNITED STATES DISTRICT JUDGE

Filed
Feb. 04 1991

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
TEXARKANA DIVISION

CHARLES L. HONEY — PLAINTIFF

v. Civil No. 89–4108

UNITED STATES OF AMERICA — DEFENDANTS

UNITED STATES OF AMERICA — COUNTERCLAIMANT

v.

CHARLES L. HONEY, JAMES W. MEADOR and FELIX P. LEE — COUNTERDEFENDANT

ORDER AND JUDGMENT

NOW on this 31st day of January, 1991, comes on the above–styled cause for the purpose of entry of judgment.

For the reasons stated in the memorandum opinion accompanying the order, the court finds that Charles Honey and James Meador are liable for unpaid taxes of $13,161.10.

IT APPEARING to the court that they have paid $150.00 and $1,000.00 respectively, the court finds that judgment should be, and hereby is, entered for the United States in amount of $12,011.10 plus legal interest.

/s/
HON. MORRIS S. ARNOLD
UNITED STATES DISTRICT JUDGE

Filed
Feb. 04 1991

APPENDIX C

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 91-1782WAT

Charles L. Honey,	*	
	*	
Appellee,	*	
	*	Order Denying Petition for
vs.	*	Rehearing and Suggestion
United States of America,	*	for Rehearing En Banc
	*	
Appellant.	*	

The suggestion for rehearing en banc is denied. The petition for rehearing is also denied.

Chief Judge Arnold took no part in the consideration or decision of this case.

June 11, 1992

Order Entered at the Direction of the Court:
/s/ Michael E. Gans
Clerk, U.S. Court of Appeals, Eighth Circuit

APPENDIX D

INTERROGATORY NO. 1

Filed
May 16, 1990

(a) Do you find that

Mr. Honey or Mr. Meador, or either of them, was a person required to collect, truthfully account for, or pay over the withheld payroll taxes to the government for Phoenix Housing Systems during any of the last three taxable quarters of 1985?

SECOND QUARTER

Charles Honey	12 responsible ___ not responsible
James Meador	12 responsible ___ not responsible

THIRD QUARTER

Charles Honey	12 responsible ___ not responsible
James Meador	12 responsible ___ not responsible

FOURTH QUARTER

Charles Honey	12 responsible ___ not responsible
James Meador	12 responsible ___ not responsible

If, and only if, you found that either of these individuals was a responsible person during any quarter, then answer the next question, but only for the person(s) and quarter(s) for whom and which you found responsibility.

(b) Do you find that

Mr. Honey or Mr. Meador, or either of them, acted willfully in failing to collect, truthfully account for, or pay over the withheld payroll taxes to the government for Phoenix Housing Systems during any of the last three taxable quarters of 1985?

SECOND QUARTER

Charles Honey	___ willful 12 not willful
James Meador	___ willful 12 not willful

THIRD QUARTER

Charles Honey	___ willful 12 not willful
James Meador	___ willful 12 not willful

FOURTH QUARTER

Charles Honey	12 willful ___ not willful
James Meador	12 willful ___ not willful

If, and only if, you found that either of these individuals was both responsible and willful during any quarter, then answer the next question, but only for the person(s) and quarter(s) for whom and which you found both responsibility and willfulness.

(c) We find that the individual(s) named became a responsible officer of Phoenix Housing Systems on:

SECOND QUARTER

Charles Honey date _____

James Meador date _____

THIRD QUARTER

Charles Honey date _____

James Meador date _____

FOURTH QUARTER

Charles Honey date Oct. 31-Dec. 31 1985

James Meador date Oct. 31-Dec. 31 1985

Gerry R. Martin
Foreman or Forewoman

5-16-90
Date

APPENDIX E

District Court's Jury Instructions

Court's Instruction No. 10
(Person Required to Collect, Truthfully Account For, and Pay Over Withholding Taxes)

An officer or an employee of a corporation is a person who is required to collect, truthfully account for, and pay the withholding taxes of a corporation if he has significant, although not necessarily exclusive, authority in the field of corporate decision-making where taxes due to the government are concerned. The person need not be an actual disbursing officer.

In determining whethe Charles Honey or James Meador was such a person for Phoenix Housing Systems, you may consider whether either of them had the final word as to what corporate bills should or should not be paid, and when; whether either of them had the power to control the decision-making process by which the corporation could choose to pay over debts instead of its withholding taxes -- I'm sorry -- to pay other debts instead of its withholding taxes; whether either of them had the power and authority to direct the payment of the withholding taxes; and whether either of them had authority to sign checks in the corporate name.

Court's Instruction No. 11
(Willful)

A person's failure to pay withheld taxes to the government is willful under the law if it was voluntary, conscious, and intentional, as opposed to accidental. However, the person need not have had a bad or evil motive, and he need not have acted with the intent to defraud the government.

Reckless disregard for whether the taxes were being paid to the government, or a failure to investigate or to correct mismanagement after having noticed that the taxes were not being paid, is willful. However, conduct amounting only to negligence or gross negligence is not willful. In other words, if a person is unaware that the taxes are not being paid, his failure to pay them is not willful.

A responsible person under the law may not absolve himself by delegating to someone else the responsibility to pay the withheld taxes.

An example of willful failure to pay is the deliberate payment of other creditors rather than the government, after knowledge that payroll taxes have not been paid, without leaving enough money in corporate accounts to pay the taxes, even if the person responsible under the law thoroughly expects that sufficient money will be on hand when the taxes are due. "Other creditors," includes employees. A person's failure to deposit the withheld taxes even before they are due is evidence of willfulness.

Court's Instruction No. 12
(Liability is Individual and Separate
From Corporation or Other Persons
Responsible Under the Law)

The liability imposed by the law on a person responsible under the law is separate and distinct from that of a corporation. The government need not attempt to collect withheld taxes from a corporation, or from another person responsible under the law, before attempting to collect from one responsible person.

However, the amount recovered from any person responsible under the law will be applied to reduce the amount due from others.

BEST AVAIL

Court's Instruction No. 13
(Limits on Period of Liability)

As to any quarter, a person may be liable as long as he was responsible for collecting or truthfully accounting for or paying the withheld taxes, and willfully failed to pay those taxes to the government.

A person's liability for taxes collected in periods before he became responsible under the law is limited to the amounts actually withheld and otherwise unobligated at the time he became responsible under the law. In other words, a person is not liable for periods before he became responsible under the law if, at the time he became responsible under the law, there was no unobligated money with which to pay the taxes to the government for those earlier periods and no money subsequently generated that was directly traceable to taxes collected but not paid earlier.

The liability of a person who has resigned is restricted to the time before his resignation when he was required to collect, truthfully account for, and pay over the withheld taxes.

ABLE COPY

APPENDIX F

Statutory Provisions Involved
(26 U.S.C.)

Sec. 3102. Deduction of tax from wages.

(a) **Requirement.** The tax imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. An employer who in any calendar quarter pays to an employee cash remuneration to which paragraph (7)(B) of section 3121(a) is applicable may deduct an amount equivalent to such tax from any such payment of remuneration, even though at the time of payment the total amount of such remuneration paid to the employee by the employer in the calendar quarter is less than $50; and an employer who in any calendar year pays to an employee cash remuneration to which paragraph (7)(C) or (1) of section 3121(a) is applicable may deduct an amount equivalent to such tax from any such payments of remuneration, even though at the time of payment the total amount of such remuneration paid to the employee by the employer in the calendar year is less than $100; and an employer who in any calendar year pays to an employee cash remuneration to which paragraph (8)(B) of section 3121(a) is applicable may deduct an amount equivalent to such tax from any such payment of remuneration, even though at the time of payment the total amount of such remuneration paid to the employee by the employer in the calendar year is less than $150 and the employee has not performed agricultural labor for the employer on 20 days or more in the calendar year for cash remuneration computed on a time basis; and an employer who is furnished by an employee a written statement of tips (received in a calendar month) pursuant to section 6053(a) to which paragraph (12)(B) of section 3121(a) is applicable may deduct an amount equivalent to such tax with respect to such tips from any wages of the employee (exclusive of tips) under his control, even though at the time such statement is furnished the

total amount of the tips included in statements furnished to the employer as having been received by the employee in such calendar month in the course of his employment by such employer is less than $20.

* * *

Section 3402. Income tax collected at source.

(a) Requirement of withholding.

(1) In general. Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Any tables or procedures prescribed under this paragraph shall

(A) apply with respect to the amount of wages paid during such periods as the Secretary may prescribe, and

(B) be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of this chapter and to reflect the provisions of chapter 1 applicable to such periods.

* * *

Section 6671. Rules for application of assessable penalties.

(a) Penalty assessed as tax. The penalties and liabilities provided by this subchapter shall be paid upon notice and demand by the Secretary, and shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in this title to "tax" imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter.

(b) **Person defined.** The term "person," as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

Section 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax.

(a) **General rule.** Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

* * *

Section 7501. Liability for taxes withheld or collected.

(a) **General rule.** Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

(b) **Penalties.** For penalties applicable to violations of this section, see sections 6672 and 7202.

Section 7512. Separate accounting for certain collected taxes, etc.

(a) General rule. Whenever any person who is required to collect, account for, and pay over any tax imposed by subtitle C, by chapter 33, or by section 4986 –

> (1) at the time and in the manner prescribed by law or regulations (A) fails to collect, truthfully account for, or pay over such tax, or (B) fails to make deposits, payments, or returns of such tax, and
>
> (2) is notified, by notice delivered in hand to such person, of any such failure,

then all the requirements of subsection (b) shall be complied with. In the case of a corporation, partnership, or trust, notice delivered in hand to an officer, partner, or trustee, shall, for purposes of this section, be deemed to be notice delivered in hand to such corporation, partnership, or trust and to all officers, partners, trustees, and employees thereof.

(b) Requirements. Any person who is required to collect, account for, and pay over any tax imposed by subtitle C, by chapter 33, or by section 4986, if notice has been delivered to such person in accordance with subsection (a), shall collect the taxes imposed by subtitle C, chapter 33, or section 4986 which become collectible after delivery of such notice, shall (not later than the end of the second banking day after any amount of such taxes is collected) deposit such amount in a separate account in a bank (as defined in section 581), and shall keep the amount of such taxes in such account until payment over to the United States. Any such account shall be designated as a special fund in trust for the United States, payable to the United States by such person as trustee.

(c) Relief from further compliance with subsection (b). Whenever the Secretary is satisfied, with respect to any notification

made under subsection (a), that all requirements of law and regulations with respect to the taxes imposed by subtitle C, chapter 33, or section 4986, as the case may be, will henceforth be complied with, he may cancel such notification. Such cancellation shall take effect at such time as is specified in the notice of such cancellation.

Supreme Court, U.S.
FILED
NOV 13 1992
OFFICE OF THE CLERK

No. 92-460

In the Supreme Court of the United States

OCTOBER TERM, 1992

CHARLES L. HONEY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

KENNETH W. STARR
Solicitor General
JAMES A. BRUTON
Acting Assistant Attorney General
RICHARD FARBER
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13pp

QUESTIONS PRESENTED

1. Whether a corporate official charged with the responsibility under Section 6672 of the Internal Revenue Code of collecting, accounting for and paying over to the United States income and social security taxes withheld from the wages of the corporation's employees is personally liable for the corporation's unpaid employment taxes when, after becoming aware of the corporation's employment tax delinquency, he continues to disburse funds from the company's checking account to satisfy the claims of other creditors.

2. Whether the court of appeals correctly directed the district court to enter judgment for the United States.

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In the Supreme Court of the United States

OCTOBER TERM, 1992

No. 92-460

CHARLES L. HONEY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-20a) is reported at 963 F.2d 1083. The opinion of the district court (Pet. App. 21a-31a) is reported at 760 F. Supp. 754.

JURISDICTION

The judgment of the court of appeals was entered on May 7, 1992. The court of appeals denied the petition for rehearing and suggestion for rehearing en banc on June 11, 1992 (Pet. App. 33a). The petition for a writ of certiorari was filed on September 9, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner and his associates Charles White and F. Peter Lee incorporated Phoenix Housing Systems, Inc. (Phoenix) in November 1984. Petitioner performed legal and financial work for the corporation, was a stockholder and member of the board of directors, and served as the corporate vice-president, secretary and treasurer (Pet. App. 2a-3a; Pet. 2-3).

Phoenix conducted business operations only during the last three quarters of 1985. Throughout that period, Phoenix failed to pay over any of the federal income and social security taxes that had been withheld from the wages of its employees (Pet. App. 2a-3a). At the end of October 1985, petitioner became aware that these withheld employment taxes had not been remitted to the Internal Revenue Service as required by law. Petitioner nonetheless allowed the corporation to continue disbursing funds to employees, suppliers, and other general creditors in an effort to keep Phoenix operating while he sought an investor to purchase the company. He made no payments towards either current or past due employment taxes. In late December 1985, two of Phoenix's lenders seized the corporate assets and thereby terminated corporate operations (*id.* at 3a).

During the period from November 1, 1985, until the demise of the corporation at the end of December 1985, Phoenix disbursed in excess of $114,000 to its general creditors. More than half of this amount was expended on corporate payroll. When the corporation ceased conducting business, its unpaid employment tax liability totaled $112,375.49. On June 20, 1988, the Internal Revenue Service assessed petitioner and several other individuals for the amount of withholding taxes due under Section

6672 of the Internal Revenue Code, 26 U.S.C. 6672.* Petitioner paid a portion of the assessed taxes and filed a claim for refund, which was denied (Pet. App. 3a-4a).

2. Petitioner then brought a tax refund action in federal district court (Pet. App. 3a-4a). The case was tried to a jury, which determined that, throughout the entire period of the company's existence, petitioner was a person charged with the responsibility under Section 6672 of collecting and paying over to the United States the employment taxes withheld from Phoenix's employees. The jury further determined, however, that petitioner became willful in his failure to pay over the corporation's employment taxes only on October 31, 1985, when he first became aware that these taxes were not being paid.

The jury did not make a determination of the *amount* of petitioner's liability, for that issue had been reserved by the parties for the district court. In determining the amount of the liability under Section 6672, the district court sought to determine whether, and to what extent, the corporation had funds available to satisfy the delinquent taxes after October 31, 1985, when petitioner became aware of the delinquency (Pet. App. 22a).

The government contended that Phoenix possessed unencumbered funds after that date that were sufficient

* 26 U.S.C. 6672(a) (1988 & Supp. II 1990) provides, in relevant part:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. * * *

to satisfy the entire amount of the delinquent payroll taxes, but that petitioner had instead used those funds to pay other creditors of the corporation. Phoenix's bank statements for the months of November and December 1985 showed a positive opening balance, deposits of $101,759.51, and disbursements to other creditors of $114,179.23, more than half of which were used to pay employee wages (Pet. App. 3a, 26a).

The district court concluded, however, that these facts did not establish that Phoenix had any unencumbered funds after October 31, 1985. In reaching this conclusion, the court stated (Pet. App. 29a):

> [A bank officer] testified that for all days in October, November and December of 1985, the checks issued by Phoenix * * * that were presented to the bank for payment, were "force paid." This term means that there were no funds available in Phoenix['s] * * * bank account to pay the checks as they were presented. Instead, the checks were held, deposits were made to cover those checks, and the amounts of the checks were then cleared. Thus, the balance of the withdrawals and deposits made on any given day had little or no bearing on the extent of unencumbered funds available to the company.

For this reason, the court concluded that petitioner was not liable for any of the delinquent taxes owed for the period prior to October 31, 1985 (Pet. App. 4a, 30a). The court held, however, that petitioner was liable for the $13,161.10 in taxes that were withheld from employees' wages during the months of November and December 1985 and not paid over to the United States.

3. The court of appeals reversed the judgment of the district court to the extent that it exonerated petitioner

for the withheld taxes owed for the period prior to October 31, 1985 (Pet. App. 1a-20a). The court held that the bank records established as a matter of law that Phoenix had sufficient unencumbered funds after October 31, 1985, to satisfy the tax obligations that had accrued prior to that date (*id.* at 6a). The court rejected petitioner's claim that all of the funds deposited into Phoenix's accounts in November and December 1985 were subject to other creditors' secured claims. The court pointed out that petitioner failed to present evidence establishing that these funds were subject to any security interest and that, even if a security interest existed, it had not been enforced and the funds had in fact been used to pay employees, suppliers, and other unsecured, general creditors (*id.* at 13a-16a). When petitioner became aware of the unpaid employment taxes, it was incumbent upon him to apply all available funds that came into the corporation's possession to the corporation's delinquent employment liabilities and, in failing to do so, he became personally liable for such taxes under Section 6672 (Pet. App. 10a).

The court of appeals rejected petitioner's contention that this Court's decision in *Slodov* v. *United States*, 436 U.S. 238 (1978), supports the proposition that a person responsible for paying withholding taxes has no obligation to pay such taxes with funds that come into the possession of the corporation *after* he becomes aware of the tax delinquencies. The court noted that *Slodov* concerned individuals who were *not* responsible for the payment of employment taxes during the period the delinquent taxes accrued. The court concluded that *Slodov* is not applicable to individuals, such as petitioner, who *were* responsible for employment taxes during the period the taxes accrued (Pet. App. 7a-10a).

The court of appeals also rejected petitioner's assertion that, under Rule 50 of the Federal Rules of Civil Procedure, judgment could not be entered for the United States because the United States had not moved for judgment notwithstanding the verdict at the conclusion of the jury trial (Pet. App. 19a). The court pointed out that the appeal had not been taken from the jury's findings. Instead, the appeal was from the district court's ruling on the *amount* of petitioner's liability. The court therefore concluded that Rule 50 did not preclude the award of judgment to the United States on appeal.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. Employers are required to withhold federal income taxes and social security taxes from the wages of their employees. 26 U.S.C. 3102 (1988 & Supp. II 1990), 3402. The taxes that are withheld constitute a fund that the employer holds in trust for the United States. 26 U.S.C. 7501. Under Section 6672 of the Internal Revenue Code, any person who is required to collect, account for, or pay over these trust fund taxes, who willfully fails to do so, becomes liable to the United States for the amount of the unpaid taxes. 26 U.S.C. 6672(a) (1988 & Supp. II 1990). See *Slodov* v. *United States*, 436 U.S. at 244-245.

Petitioner asserts (Pet. 13-19) that, under Section 6672, a person who was under a duty at all pertinent times to collect and pay over employment taxes, but who did not become aware until a later time that taxes for earlier quarters had not been paid by his employer, is not required to apply available funds that come into his em-

ployer's possession thereafter to the payment of the withheld taxes. As petitioner concedes (Pet. 14 n.12, 17-19), however, every court of appeals that has considered this question, including the court in this case, has disagreed with petitioner's contention. See Pet. App. 5a-19a; *Davis* v. *United States*, 961 F.2d 867, 871-878 (9th Cir. 1992); *United States* v. *Vespe*, 868 F.2d 1328, 1334-1335 (3d Cir. 1989); *Kizzier* v. *United States*, 598 F.2d 1128, 1134 (8th Cir. 1979); *Garsky* v. *United States*, 600 F.2d 86, 90-91 (7th Cir. 1979); *Mazo* v. *United States*, 591 F.2d 1151, 1156-1157 (5th Cir.), cert. denied, 444 U.S. 842 (1979). See also *Turnbull* v. *United States*, 929 F.2d 173 (5th Cir. 1991); *Purdy Co.* v. *United States*, 814 F.2d 1183, 1188 (7th Cir. 1987); *Wood* v. *United States*, 808 F.2d 411 (5th Cir. 1987). As the Fifth Circuit stated in *Mazo* v. *United States*, 591 F.2d at 1157:

> In the case of individuals who are responsible persons both before and after withholding tax liability accrues * * * there is a duty to use unencumbered funds acquired after the withholding obligation becomes payable to satisfy that obligation; failure to do so when there is knowledge of the liability * * * constitutes willfulness.

2. There is no merit to petitioner's contention (Pet. 16-24) that these consistent decisions of the courts of appeals conflict with this Court's decision in *Slodov* v. *United States*, *supra*. In *Slodov*, the Court addressed the situation of an individual who becomes responsible for a corporation's withholding taxes *after* prior management (i) has used the funds represented by those taxes to pay other creditors and (ii) has left the corporation with no unencumbered funds with which to pay the taxes owed the United States. In these circumstances,

the Court held that the newly responsible individual is obligated to use funds that subsequently come into the corporation's possession to satisfy the prior tax delinquency only when the after-acquired funds are directly traceable to the dissipated trust fund taxes. 436 U.S. at 238.

Unlike the situation in *Slodov*, petitioner was at all times responsible for collecting and paying over Phoenix's trust fund taxes. He was therefore under a continuing duty to apply all unencumbered funds received by the corporation to satisfy the withholding tax obligations. His failure to do so constituted a willful failure to carry out his duties to the United States, thereby rendering him liable for the unpaid taxes under Section 6672. Nothing in *Slodov* supports petitioner's claim that an individual who *is* a responsible person when the withholding taxes accrued has no obligation to use funds acquired by the corporation afterwards to satisfy the unpaid taxes. As the Seventh Circuit stated in *Garsky* v. *United States*, 600 F.2d at 91:

> *Slodov* does not relieve a "responsible person" of the responsibility to reduce accrued withholding tax liability with funds acquired after the funds actually withheld have been dissipated so long as the person responsible has been so throughout the period the withholding tax liability accrued and thereafter. * * *

Accord *Kizzier* v. *United States*, 598 F.2d at 1130; *Mazo* v. *United States*, 591 F.2d at 1154; *Davis* v. *United States*, 961 F.2d at 876-878.

3. Petitioner errs in asserting (Pet. 24-27) that the funds that came into Phoenix's possession after October 31, 1985, were encumbered by claims of other creditors. The corporation's bank records establish that during the

months of November and December 1985 Phoenix made payments from its checking account to unsecured, general creditors, employees, and suppliers, totaling approximately $114,000. This amount exceeded the amount of unpaid withholding taxes (Pet. App. 3a). While these funds were available to pay the taxes due the United States, the corporation instead used those funds to pay the claims of other creditors (*ibid.*).

Petitioner asserts (Pet. 26) that the funds disbursed from the corporation's checking account during November and December were encumbered by a security interest possessed by the Merchants & Planters Bank & Trust Company (Merchants). While the record shows that Merchants obtained a security interest in Phoenix's inventory and the proceeds from sales of such inventory, there was no evidence that any of the funds deposited into Phoenix's checking account in fact represented proceeds from the sale of inventory (Pet. App. 13a-14a). As the court of appeals concluded (*ibid.*), the factual premise for petitioner's argument is therefore not established in the record.

Even if it were assumed that *some* of the funds deposited into the corporation's checking account were from the sale of inventory, none of those funds were encumbered by the bank's claim in any event. Paragraph 6 of the security agreement between Merchants and Phoenix provides that, upon Merchants' demand, Phoenix would be required to deposit the proceeds from inventory sales into a special bank account controlled by Merchants. But there is no evidence that Merchants ever invoked this provision (Pet. App. 15a). On the contrary, the record reflects that such restrictions were not imposed on Phoenix (*id.* at 15a-16a), for Phoenix did not use any of the funds deposited in its checking ac-

count during November and December 1985 to repay its obligations to Merchants. Instead, the funds were used to pay employee wages and the claims of other general, unsecured creditors and were not encumbered by the bank's potential security interest (*id.* at 3a).

4. The court of appeals also correctly rejected petitioner's contention that, under Rule 50 of the Federal Rules of Civil Procedure, the fact that the United States did not move for judgment notwithstanding the verdict precluded the award of any relief to the United States other than a new trial. As the court of appeals pointed out (Pet. App. 19a), the United States did not challenge the jury's verdict on appeal. The question on appeal instead concerned the calculation made by the district court concerning the amount of petitioner's liability. Rule 50 therefore has no application to this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 92-460

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OCTOBER TERM, 1992

CHARLES L. HONEY,
PETITIONER
v.
UNITED STATES OF AMERICA,
RESPONDENT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF OF PETITIONER

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REPLY BRIEF FOR THE PETITIONER

The brevity of the government's argument in its Brief in Opposition in response to the three specific questions presented by the Petitioner, represents the government's continual monolithic assertion of its "strict liability" argument (first asserted before this Court in *Slodov v. United States*, 436 U.S. 238 (1978)) for the imposition of the "100% penalty" provided by 26 U.S.C. § 6672. The government's apparent refusal to address the merits of the substantive arguments raised by the Petitioner, especially with regard to the applicability of the "brightline rules" mandated by this Court in its *Slodov* opinion, represents the government's arrogant use of this heavy "100% penalty" to try and impose liability for this penalty, "as a matter of law," especially in situations where juries have found, "as a matter of fact," that the responsible person

did *not* act *willfully* (as required by § 6672) in causing the failure of the corporate employer to pay over the withheld "trust fund" payroll taxes, where those payroll taxes have been dissipated by prior management without the knowledge of the responsible person.

The following points are addressed to the government's assertions, in its Brief in Opposition, that there are no conflicts between the decision in this case and this Court's prior decision in *Slodov*, as well as the decisions of other inferior federal courts, on the three questions presented by this Petition.

I. THE GOVERNMENT'S ARGUMENT THAT THE PETITIONER ACTED "WILLFULLY," AS A MATTER OF LAW, IS AN IMPROPER INTERPRETATION OF THIS COURT'S BRIGHT LINE RULES LAID DOWN BY THIS COURT IN *SLODOV* FOR ADMINISTERING THE "100% PENALTY," AND THE EIGHTH CIRCUIT'S ACCEPTANCE OF THE GOVERNMENT'S ARGUMENT, CONFLICTS WITH DECISIONS OF OTHER FEDERAL CIRCUIT COURTS.

Without addressing the obvious question of how any "trust fund" status (26 U.S.C. § 7501) can be imposed upon "after acquired funds" of a corporation (when the actual withheld payroll taxes have been dissipated by prior management, *before* the responsible person becomes knowledgeable of such fact), the government argues (Br. Opp. 6–8), on the first question presented here, that a responsible person (in a factual setting like that of the Petitioner in this case) has an absolute and continuing duty to apply *all* unencumbered funds received by the corporation to satisfy the prior payroll tax delinquencies. In essence, the government is again asserting its "strict liability" argument that it proffered to this Court in the *Slodov* case, based solely upon the corporate shareholder's *status* as a responsible person, without there being any showing of either (1) *willfulness* on the part of the responsible person to pay over the delinquent employment taxes, or (2) any

nexus between the withheld payroll taxes that give rise to the "100% penalty" assessment, and the after acquired funds of the corporation.

Instead of applying the surgeon's scalpel to the facts presented to determine the elements of *willfulness* on the part of the responsible person (as this Court did in its *Slodov* decision), the government simply wields a blunt hatchet in stating its legal position where its attempt to cut off, "as a matter of law," the Petitioner's right to claim the safe harbor limitations on the "100% penalty" mandated by this Court in *Slodov*. The government's basic argument is essentially the same as the one rejected by this Court in *Slodov*, i.e. once a responsible officer, the willfulness factor can be attributed at any time, even after the taxable quarters have closed and there is no *nexus* to the delinquent payroll taxes, if corporate funds are ever paid to other creditors.

a. There is a conflict between the Eighth Circuit's decision in this case, and decisions of other federal circuit courts, regarding the applicability of the "as a matter of law" standard argued by the government.

A review of the government's general litigating position in "100% penalty" cases, since this Court rendered its *Slodov* decision, reveals that the IRS usually applies the shotgun approach of assessing this heavy civil penalty against every possible responsible officer, and then the government urges the district and appellate courts to hold such individuals liable for this heavy penalty, "as a matter of law," wherever the facts present an instance in which other corporate creditors were paid with the corporation's after acquired funds. Besides the arguments on this point that are set forth by Charles Honey in his original Petition (Pet. 16–24), the Petitioner submits that the very recent decision by the Fourth Circuit Court of Appeals in the case of *Turpin v. United States*, 970 F.2d 1344 (C.A.4, 1992) is in direct conflict with the decision of the Eighth Circuit Court of Appeals in this *Honey* case, regarding

the proper application of the *willfulness* standard of § 6672. [1] In its recent *Turpin* decision, the Fourth Circuit specifically reversed the district court's granting of *judgment notwithstanding the verdict* for the government, where the district court overruled the jury's factual findings and held that Mr. Turpin had acted *willfully*, "as a matter of law," in allowing other creditors to be paid with the corporation's after acquired funds. As in the instant *Honey* case, the jury in the *Turpin* case had found that the corporate shareholder was a responsible person throughout the period in which the payroll tax delinquencies accrued, but the jury in *Turpin* specifically found that Mr. Turpin had *not* acted *willfully* in allowing these payroll tax delinquencies to accrue. [2]

Thus, even though Charles Honey and Henry Turpin were found, "as a matter of fact," by two juries to have been in virtually

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[1] The time within which the government could have filed a timely Petition for Certiorari to this Court in the *Turpin* case expired on October 15, 1992, without the filing of such a Petition by the government. Therefore, an additional reason now exists for this Court to grant the Petitioner's request for review of the Eighth Circuit's decision in the instant case, because there now exists a clear and direct conflict between decisions of the Eighth Circuit and the Fourth Circuit as to how this "willfulness" standard mandated by this Court in its *Slodov* decision is to be applied in very similar factual circumstances.

[2] This is exactly the same factual situation that is presented in the instant case, since the jury in the district court here found that Mr. Honey was a responsible person throughout the nine (9) month period that the payroll tax delinquencies accrued, but that Mr. Honey had *not* acted *willfully* in allowing such payroll tax delinquencies to accrue for the first seven (7) months of this nine (9) month period. (See, jury's answers to special interrogatories (a), (b) and (c), Pet. App. D, Pet. 34a–36a). Also, it should be noted that the government never raised this "duty to use after acquired funds" argument in the *Turpin* case, even though it is obvious from the Fourth Circuit's opinion that Mr. Turpin continued to be active in the corporate employer's business for more than four months after the last quarter for which the payroll tax delinquencies accrued. Finally, the Fourth Circuit specifically noted this Court's limitation on the use of the term "responsible officer," in footnote 7 of its *Slodov* decision, and that circuit court applied the same limitation in reaching its decision in the *Turpin* case. 970 F.2d, at 1347, ftnt. 3.

the same position, the government's assertion of this "100% penalty" against each of these individuals has resulted in totally different determinations, solely because of antonymous interpretations made by the Eighth Circuit and the Fourth Circuit of this Court's bright line rules mandated in *Slodov* for the administration of the "100% penalty" provided by § 6672. Under virtually the same factual circumstances, Mr. Turpin has been found to qualify for the safe harbor limitations from this extremely heavy penalty (because of the jury's finding of his lack of *willfulness)*, but Mr. Honey has been denied the benefit of this same safe harbor and he must suffer the imposition of this heavy penalty, "as a matter of law," even though his jury had also found that he had not acted *willfully* in allowing the payroll tax delinquencies to accrue. The Eighth Circuit's erroneous interpretation of this Court's bright line rule mandated by *Slodov* has resulted in Mr. Honey being placed in a totally different financial condition, regarding his liability for this penalty, than the Fourth Circuit has placed Mr. Turpin, who is a similarly situated person.

Other recent decisions of federal appellate courts have also rejected the government's continually asserted "litigating position" that responsible persons are strictly liable for this 100% penalty, "as a matter of law." See the decision of the Seventh Circuit in *Sawyer v. United States*, 831 F.2d 755 (C.A.7, 1987) and the Fifth Circuit in *Gustin v. United States*, 876 F.2d 485 (C.A.5, 1989). [3]

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[3] The Petitioner also points out that the rationale adopted by the Fifth Circuit's decision in its *Gustin* case, in effect, undercuts the rationale of the Fifth Circuit's earlier decision in *Mazo v. United States*, 591 F.2d 1151 (C.A.5), *cert. denied*, 444 U.S. 842 (1979). This *Mazo* decision is the seminal case cited by the government that erroneously adopted the government's argument for distinguishing the applicability of this Court's *Slodov* standards for *willfulness* under § 6672 in situations where the responsible person had no knowledge of the accrual of the payroll tax delinquencies, until after they accrue and the "trust fund" moneys had been dissipated by others. The Petitioners notes that the government cites language from this *Mazo* decision by the Fifth Circuit (Br. Opp. 7) as its base of authority for the legal position it attempts to defend in this proceeding.

This Court should grant Charles Honey's Petition in this case, so as to utilize the facts of this case as a vehicle for clarifying the applicability of the *willfulness* standards this Court originally mandated in *Slodov* to factual situations (like those presented here) that have no real distinguishing characteristics from those presented in *Slodov*. The government has continually argued to the inferior federal courts that the responsible person's *status* alone is sufficient reason to distinguish these cases from *Slodov*, and is sufficient reason to hold these responsible persons *willful* (and strictly liable for this heavy "100% penalty"), "as a matter of law," even though such responsible persons (like Dr. Slodov) were not knowledgeable of the payroll tax delinquencies when they accrued and there were no traceable "trust funds" (available with a *nexus* to these delinquent payroll taxes) when the responsible persons acquired effective financial control of the corporate employer. It is obvious that there is confusion and conflict on this question among the decisions of the inferior federal courts, as noted in Mr. Honey's Petition (Pet. 17–19). The Petitioner in this case should not be made to suffer the devastating financial consequences that flow from the Eighth Circuit's erroneous application of the *willfulness* standards, when similarly situated responsible officers have been excused from such penalty by the correct application of such *willfulness* standards by the Fourth Circuit and other inferior federal courts.

II. THE QUESTION OF WHAT CONSTITUTES UNENCUMBERED FUNDS IS AN IMPORTANT ISSUE THAT HAS NOT PREVIOUSLY BEEN ADDRESSED DEFINITIVELY BY THIS COURT, BUT SHOULD BE ADDRESSED IN THIS CASE

In attempting to respond to the Petitioner's arguments on the second question raised in his Petition (Pet. 24–27), the government does *not* even mention, let alone rebut, the Petitioner's citation to this Court's ruling in *Slodov* (436 U.S. at 259) on the use

of these after acquired funds by the responsible person. [4] Instead, the government merely argues (Br. Opp. 8–10) that the after acquired funds held in the corporate employer's bank account in this case were unencumbered (even though there was a superior security interest in *all* such funds in favor of a third party bank), because the holder of the security interest did not direct as to what corporate creditors could be paid with these funds by Phoenix Housing in the company's day–to–day operations. Such an incredibly narrow definition of "unencumbered funds," for purposes of § 6672, is not in accord with the policy considerations addressed by this Court in its *Slodov* opinion regarding the collection of taxes versus the rehabilitation of financially troubled businesses. Also, the government's argument fails to note that such directive action by the bank (as the security interest holder) might well expose the bank to a similar penalty liability for these delinquent payroll taxes. (26 U.S.C. § § 3505 and 6672).

In this case, it was quite evident that the total of $114,000.00 would *not* have been run through the corporate bank account in the last two months of the corporation's operations, [5] if any substantial portion of those moneys had been used to pay the prior corporate payroll tax delinquencies, instead of the then current payrolls of the corporation's employees. Clearly, the employees would have quit, the corporation would have ceased operations earlier, and the government's measure of the responsible officer's liability would have been reduced substantially in this case, because $114,000.00 would *not* have been generated from the

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[4] There, this Court noted that surely Congress did not intend to hammer a responsible person with the threat of a heavy "100% penalty" for the responsible person's failure to direct the payment of after acquired corporate funds to satisfy prior payroll tax delinquencies when the IRS could *not* assert a superior security or lien interest in such after acquired funds, if the IRS levied directly upon such funds.

[5] With $114,000.00 includes $20,000.00 personally borrowed and contributed to Phoenix Housing by James Meador, one of the other persons assessed with the "100% penalty" in this case.

corporation's "business cycle" of depositing proceeds from accounts receivable into the corporate bank account. This is exactly the situation that was cogently addressed by District Judge Morris Arnold in his Opinion in this case (760 F. Supp. 754) where he stated (Pet. 27a):

> Because the government's test perhaps has about it a deceptive aura of rectitude and equity, and might therefore seem to be the one the court should adopt, the court will devote some discussion to demonstrate the unreliability of its proposed method.

The district judge then demonstrated, by illustrative example, why the redeposit of proceeds collected in the business cycle into the corporate bank account should *not* be used as the sole measure for a corporation's available "unencumbered funds."

Since the only decision of this Court addressing this important "unencumbered funds" issue is the mention of such terms in this Court's *Slodov* decision (436 U.S. at 259), and because the rationale adopted by the Eighth Circuit for the measurement of "unencumbered funds" in this case is diametrically opposed to the rationale set forth by this Court in *Slodov*, the Petitioner submits that the Court should grant his Petition and utilize this case to render a definitive opinion regarding this "unencumbered funds" issue.

III. THE CIRCUIT COURT'S RENDERING OF A DECISION FOR THE GOVERNMENT, INSTEAD OF REMANDING THE FACTUAL QUESTION TO THE DISTRICT COURT, DENIES THE PETITIONER HIS RIGHTS TO PROCEDURAL DUE PROCESS.

The question of what constitutes "unencumbered funds," for purposes of the applicability of the "100% penalty" provided by § 6672, was decided by the Eighth Circuit, on appeal, in this very case. Though this factual question was reserved by the parties to

the district court, the district court's findings on this issue were inextricably intertwined with the findings of the jury regarding the Petitioner's status as a responsible person and his lack of willfulness, under the standards set by this Court for imposing liability for this heavy penalty under § 6672.

Clearly, pursuant to the provisions of Rule 50(d) of the Federal Rules of Civil Procedure, Petitioner Honey timely filed a formal written request for a new trial with the circuit court, prior to the submission of this case to that court for decision. The Eighth Circuit's decision granted, "as a matter of law," what was, *in effect*, the government's unfiled motion *jnov*, by holding that the Petitioner had acted *willfully* in failing to pay over after acquired funds of the corporate employer to the IRS to satisfy the corporation's prior payroll tax delinquencies. In essence, there is absolutely no difference between the thrust of the government's "litigating position" in this *Honey* case, and its "litigating position" in the *Turpin, supra,* case, except that the net result of the Fourth Circuit's decision, in interpreting this Court's *Slodov* standards, upheld the jury's determination, and the Eighth Circuit, in misapplying this Court's *Slodov* standards has refused to accept the jury's findings *or* to give the Petitioner an opportunity to submit this factual question to a jury.

When the rules of the game are changed or set by the appellate court, on an appeal in the case being reviewed, it is only equitable that the Petitioner be entitled to at least the opportunity to try to meet his burden of proof under the *new* standards adopted by the Eighth Circuit for imposing liability under § 6672. Therefore, the Petitioner submits that the government has offered no cogent reason (Br. Opp. 10) as to why he should not be entitled to a new trial on the factual question on the availability of "unencumbered funds" in this case, as opposed to being held strictly liable for this heavy penalty, "as a matter of law," based upon *new* standards and rules adopted by the Circuit Court on appeal in this case itself.

CONCLUSION

For the foregoing reasons, the Petitioner submits that his Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit should be granted.

Respectfully submitted,

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